

DIRECTORATE-GENERAL FOR EXTERNAL POLICIES  
**POLICY DEPARTMENT**



## **Workshop**

# **Bringing EU-Turkey trade and investment relations up to date?**

**INTA**



## WORKSHOP

# Bringing EU-Turkey trade and investment relations up to date?

### ABSTRACT

The case is made that the EU-Turkey CU of 1995 covering industrial goods should be modernised and modified to take into account the various and growing criticisms of the original CU. Furthermore, economic integration between the EU and Turkey should be strengthened by signing a complementary deep integration regional trade agreement (RTA) between the EU and Turkey, covering agriculture, SPS measures, services, government procurement, investment, and dispute settlement. For Turkey, the objective would be to achieve comprehensive liberalisation, while for the EU this is an ideal opportunity to harness the economic and political potential of deeper integration with Turkey, in line with its wider trade and investment policy.

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This paper was requested by the European Parliament's Committee on International Trade.

English-language manuscript was completed on 19 May 2016.

Printed in Belgium.

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This paper will be published on the European Parliament's online database, '[Think tank](#)'.

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ISBN: 978-92-823-9226-3 (pdf)

ISBN: 978-92-823-9227-0 (print)

doi:10.2861/36454 (pdf)

doi:10.2861/320905 (print)

Catalogue number: QA-02-16-462-EN-N (pdf)

Catalogue number: QA-02-16-462-EN-C (print)

# WORKSHOP

POLICY DEPARTMENT, DG EXPO FOR  
THE COMMITTEE ON INTERNATIONAL TRADE (INTA)



Thursday, 17 March 2016 – **10:00-12:30**  
PAUL-HENRI SPAAK BUILDING – ROOM **P4B001**

## Bringing **EU - Turkey** trade and investment relations **up to date?**



Chairman:  
**Bernd LANGE**

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## Programme of the Workshop

DIRECTORATE-GENERAL FOR EXTERNAL POLICIES

POLICY DEPARTMENT



For the Committee on International Trade (INTA)

### WORKSHOP

#### Bringing EU - Turkey trade and investment relations up to date?

Thursday, 17 March 2016

Brussels, PHS building, Room P4B001 10:00

Interpretation: FR/DE/IT/EN/ES/TR

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#### DRAFT PROGRAMME

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- |              |   |
|--------------|---|
| <b>10.00</b> | <b>Welcome and introductory remarks by the Chair</b>  |
| <b>10.10</b> | <b>A modern trade and investment relationship: EU and Turkey expectations</b> <ul style="list-style-type: none"><li>• <b>Ignacio GARCIA BERCERO</b>, Director, European Commission, DG Trade</li><li>• <b>Murat YAPICI</b>, Director General for EU Affairs, Ministry of Economy, Turkey</li></ul>  |
| <b>10.50</b> | <b>Q&amp;A, Open discussion</b>   |
| <b>11.10</b> | <b>Developing the potential of EU-Turkey trade and investment relations</b> <ul style="list-style-type: none"><li>• <b>Dr Sübidey TOGAN</b>, Professor of Economics and Director of Center for International Economics, Bilkent University, Ankara, Turkey</li><li>• <b>Dr Kamala DAWAR</b>, Lecturer in commercial and trade law, University of Sussex, UK</li></ul> |
| <b>11.50</b> | <b>Q&amp;A, Open discussion</b>   |
| <b>12.15</b> | <b>Concluding remarks by the Chair</b>  |

## Biographical summaries of the speakers

DIRECTORATE-GENERAL FOR EXTERNAL POLICIES

POLICY DEPARTMENT



For the Committee on International Trade (INTA)

### WORKSHOP

### Bringing EU - Turkey trade and investment relations up to date?

Thursday, 17 March 2016

Brussels, PHS building, Room P4B001 10:00

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#### BIOGRAPHICAL SUMMARIES OF THE SPEAKERS

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#### Ignacio GARCIA BERCERO

Mr Ignacio Garcia Bercero is a director at the Directorate General for Trade of the European Commission (DG TRADE). He currently oversees activities related to the US, Canada and the EU Neighbouring Countries. Mr Garcia Bercero coordinated the work of the EU-US High Level Working Group on Growth and Jobs, which recommended the launch of the Transatlantic Trade and Investment Partnership (TTIP) negotiations. He now acts as the EU Chief Negotiator for this agreement.

Mr Garcia Bercero joined the European Commission in 1987 and has thorough experience in a large number of trade-related policy areas.

During the Uruguay Round of multilateral negotiations, he followed, inter alia, negotiations on trade safeguards, GATT articles, functioning of the GATT, as well as talks on trade and environment. In the period leading up to the launch of the WTO Doha Round, he served as coordinator of the EU WTO policy and led the negotiations on trade and competition. He was also posted in the EU Delegation to the United Nations in New York and worked in areas of WTO Dispute Settlement and Trade Barriers Regulation.

More recently, between 2005 and 2011, Mr Garcia Bercero's field of responsibility included trade-related aspects of sustainable development, as well as bilateral trade relations with South and South-East Asia, Korea, EuroMed and the Middle East countries. As the Chief Negotiator, he led the negotiating process with South Korea and India.

Mr Garcia Bercero authored several papers and publications on the subjects of Trade Laws, GATT and WTO System, Safeguard Measures, Trade and Competition, WTO Dispute Settlement Reform and bilateral dispute settlement rules in European Free Trade Agreements.

Mr Garcia Bercero holds a Law Degree from the Faculty of Law of the Universidad Complutense, Madrid and a Masters of Laws Degree (with Distinction) from University College, London.



## Murat YAPICI

Mr Murat Yapici is the Director General for EU Affairs at the Ministry of Economy, Turkey. He is currently in charge of EU affairs, Customs Union and free trade agreements (FTAs) with third countries. Mr Yapici is the Chief Negotiator for Turkey's trade agreements and Co-chairs Joint Committees under the EU-Turkey Customs Union and other FTAs.

Mr. Yapici joined the Turkish Ministry of Economy in 1986 and has a large experience in bilateral, regional and multilateral trade relations, including WTO issues and trade defence related matters. He is Turkey's nominated Panelist to the Indicative List of Panelist under the WTO Dispute Settlement Mechanism. During his career Mr. Yapici has been posted to the Turkish Embassies in Tokyo and London where he served as Deputy Economic and Commercial Counsellor and Chief Economic Counsellor, respectively.

Mr. Yapici holds a Master of Science Degree from the Middle East Technical University, Ankara and a Master of Business Administration Degree from the Faculty of Political Sciences Ankara University.

## Dr Sübidey TOGAN

Professor of Economics and Director of Center for International Economics, Bilkent University, Ankara, Turkey

Dr Togan received his Ph.D. in Economics from the Johns Hopkins University in Baltimore. Prior to joining Bilkent University he taught at Texas A&M University, Clarkson University and Middle East Technical University. His publications include 'Foreign Trade Regime and Trade Liberalization in Turkey during the 1980's' published in 1994 by Avebury, 'The Economy of Turkey since Liberalization' published in 1996 by Macmillan Press Ltd (co-editor V. N. Balasubramanyam), 'Turkey and Central and Eastern European Countries in Transition: Towards Membership of the EU' published by Palgrave Macmillan Ltd. in 2001 (co-editor V.N. Balasubramanyam), 'Turkey: Economic Reform & Accession to the European Union' published by the World Bank and Centre for Economic Policy Research (CEPR) in 2005 (co-editor B. Hoekman), 'Macroeconomic Policies for EU Accession' published by Edward Elgar Publishing in 2007 (co-editors E. Başçı and J. von Hagen), and Economic Liberalization and Turkey' published by Routledge in 2010. His recent book 'The Liberalization of Transportation Services in the EU and Turkey' will be published in June 2016 by Oxford University Press. His area of interest is International Economics.

## Dr Kamala DAWAR

Lecturer in commercial and trade law, University of Sussex, UK

Kamala Dawar is an international trade and competition law specialist. She holds a PhD in International Trade Law (magna cum laude) from the Graduate Institute, Geneva and an LLM in International and European Trade Law from the University of Amsterdam Law School. She also holds an MSc in Comparative Government (Distinction) from the London School of Economics and a B.A. Politics (First Class) from the University of the West of England.

In addition to teaching courses on international trade law, international commercial law and international financial law, Kamala conducts research, policy analysis and training for academic, inter-governmental and non-governmental organisations, including the WTO, World Bank, the European Commission and public interest organisations.

Kamala has published articles on trade and development issues including WTO law and governance, public procurement law and policy, competition law and consumer policy, preferential trading arrangements and development issues.

## Introduction

Doubts about the desirability or feasibility of the full accession of Turkey to the EU in the short run have increased substantially in recent years, due to both the internal direction of the Turkish government and the economic and security challenges facing the broader EU. Yet despite recent trends, there is little reason for either Turkey or the EU and its Member States to unilaterally break with Turkey's accession process. In fact, as this paper will show, the various interdependencies of the two partners, as well as the high potentials of their partnership in terms of politics and security, economy, trade and energy, can offer economic benefits for both sides and help to overcome the issues currently seen in their relationship.

Nevertheless, the current framework of interaction between the two countries is over twenty years old; the EU-Turkey customs union (CU) was agreed upon in 1995 and is becoming increasingly out-dated. Both the EU and Turkey are aware that the pre-internet age EU-Turkey CU no longer meets the requirements of 21st century for trade relations. Consequently, the Turkish government is interested in up-dating the EU-Turkey trade and investment relations, but it is not sure how this updating should take place. Under these circumstances, the solution for confronting mutual economic challenges may not only be a substantial re-think of the existing CU but a move towards greater economic integration.

This paper assesses the case for modernising EU-Turkey trade and investment relations. It offers the point of view that any updating of the CU should seek to deepen economic ties between the EU and Turkey. The sum of our analysis is that the EU-Turkey CU of 1995 should be modernised and modified to take into account the various and growing criticisms of the CU. Furthermore, economic integration between the EU and Turkey should be strengthened by signing a complementary deep-integration regional trade agreement (RTA) between the EU and Turkey covering agriculture, SPS measures, services, government procurement, investment, and dispute settlement.

Such an approach should increase competition and lead to better allocation of resources in both Turkey and the EU, as well as other benefits for both partners. From the point of view of Turkey, signing a deep integration regional trade agreement (RTA) with the EU should increase market access for agricultural commodities in the EU market through the elimination of tariff and non-tariff barriers while increasing market access in services and public procurement markets by aligning the regulatory framework between the parties in services and public procurement. Turkey is realising the importance of global value chains trade, and the advantages of concluding a deep and comprehensive FTA covering agriculture, SPS measures, services, government procurement, and investment and dispute settlement chapters will be economically significant.

Gains are possible from the EU side as well. Deepening the EU-Turkey integration would help to strengthen the global role of the EU, and lead to improved market access for EU firms in Turkish agricultural commodities and services markets. It would also provide enhanced access for EU firms to Turkish government procurement market. An expanded RTA should additionally cover the liberalisation of investment, both in most of the services and non-service sectors, including performance requirements to ensure environmental, social and labour standards are met. Through such a modernisation, the RTA will be able to create substantial new trade opportunities for EU firms in goods and services as well as in increasing sustainable investment.

Moreover, such a move would bring EU-Turkey trade and investment relations into line with current EU RTAs, such as the KOREU, EU-Canada CETA, and the emerging Trans-Atlantic Trade and Investment Partnership (TTIP), which contain much stronger provisions than the EU-Turkey CU. The TTIP negotiations actually offer much instruction for the blue print of liberalisation of trade between the EU and Turkey, with its mix of a harmonisation approach in some areas and mutual recognition or mutual equivalence in others; such a mix may make it easier for Turkey to fulfil the requirements of any expanded RTA.

The rest of the paper proceeds as follows. The following section examines the structure of the CU and what it has meant for both Turkey and the EU, while the Section 2 performs an assessment of the EU-Turkey CU from the point of view of both parties. Section 3 considers the wider context of recent developments in the world economy, before focusing on the question of how to update EU-Turkey trade and investment relations to identify the various options facing Turkey and the EU. Finally, the Section 4 concludes with some recommendations related to this analysis.

# 1 The European Union-Turkey customs union

In order to understand the future of any new or expanded trade and investment agreement between the EU and Turkey, it is instructive to identify how the previous agreement has affected the partners. This section identifies the legal framework governing the EU – Turkey Customs Union and assesses how it has functioned to structure trade relations between the two parties. It then focuses on regulatory and behind-the-border policies before turning to the quantitative impact that can be attributed to the Customs Union.

## 1.1 The framework regulating EU-Turkey trade and investment relations

Turkey first applied for associate membership of the then-European Economic Community (EEC) in 1959. The application resulted in an Association Agreement (the Ankara Agreement) between the EEC and Turkey in 1963, whereby the parties agreed to create, inter alia, a Customs Union (CU). In 1970, an Additional Protocol was signed, setting out a timetable for abolishing tariffs and quotas on goods circulating between the parties. The CU was established on January 1, 1996 through the European Union (EU) -Turkey Association Council Decision 1/95, covering industrial goods including industrial component of processed agricultural commodities but excluding European Coal and Steel Community (ECSC) products. A free trade agreement (FTA) between the ECSC and Turkey was signed on February 29, 1996, with European Commission Decision 96/528/ECSC covering the ECSC products.

The EU-Turkey CU Decision 1/95 of 1995 required Turkey to eliminate all customs duties, quantitative restrictions, charges with an equivalent effect to customs duties, and all measures with an equivalent effect to quantitative restrictions in the trade of industrial goods with the EU as of January 1, 1996. In addition, Turkey was required to adopt the EU's Common External Tariffs (CET) on third-country imports and adopt all the preferential agreements the EU had/has concluded and would/will conclude with third countries. Consequently, this has meant that Turkey has also concluded FTAs with Israel, Macedonia, Bosnia-Herzegovina, Palestine, Tunisia, Morocco, Syria, Egypt, Albania, Georgia, Montenegro, Serbia, Chile, Jordan, Mauritius, South Korea, and Malaysia over the past twenty years, in tandem with the EU.<sup>1</sup>

Alongside this economic integration in industrial goods under the customs union, the EU and Turkey have had a separate process related to Turkey's accession to the EU. This two-track approach has created a complex relationship between the two parties. This was highlighted in 2004 when the European Council opened the accession negotiations with Turkey by emphasising that the:

[N]egotiations are an open-ended process, the outcome of which cannot be guaranteed beforehand' but that 'while having full regard to all Copenhagen criteria, including the absorption capacity of the Union, if Turkey is not in a position to assume in full all the obligations of membership it must be ensured that Turkey is fully anchored in the European structures through the strongest possible bond.

As a result of the open-ended nature of the Accession process, an unprecedented situation has emerged whereby on the one hand, Turkey's integration process with EU regulatory regimes, as initiated under the Ankara Agreement, has moved far beyond other EU trade partners' regulatory obligations. On the other hand however, as Section 3.1 discusses further, third parties that are not in accession to the EU, have secured market access commitments from the EU in the areas of services, investment, public procurement, geographical indicators and agriculture that extend far beyond those provided by the legal framework of the EU-Turkey CU. When compared to the state of the art agreements signed between the

<sup>1</sup> In 1991, Turkey signed a FTA with European Free Trade Association (EFTA) countries. The FTA between Turkey and Syria was suspended on December 6, 2011.

EU and Canada, for example, or the emerging mega-regionals such as Trans-Atlantic Trade and Investment Partnership (TTIP), the shallow and narrow nature of the EU-Turkey agreement is all too apparent.

### 1.1.1 The scope of the EU – Turkey CU

The CU immediately appears outmoded because of its narrow focus, applying only to industrial goods, including the industrial components of processed agricultural products produced in the Community or Turkey. The CU also includes those goods wholly or partially manufactured from products coming from third countries but which are in free circulation in the Community or in Turkey.<sup>2</sup>

The rules determining the origin of a good are based on the principle of goods being wholly obtained in the exporting country, or substantially transformed there in accordance with product-specific rules. This is consistent with the approach followed in other EU RTAs signed during the 1990s. Under this approach, products not wholly obtained are subject to origin criteria that specify how much transformation of non-originating materials must have taken place before a product can be considered eligible for preferences. Consequently, for the EU-Turkey Customs Union, products from third countries can only be considered to be in free circulation in the Community or in Turkey under the following circumstances: a) if the import formalities have been complied with, b) if any customs duties or charges having equivalent effect have been levied in the Community or in Turkey, and c) if they have not benefited from a total or partial reimbursement of such duties or charges. As a result, since the entry into force of the CU Turkey's average MFN tariffs for industrial products has fallen significantly, and has remained low due to the 'anchor' provided by the Common External Tariff. However, for those sectors not covered by the CU, and most notably for agriculture, Turkey's applied MFN tariffs have in more cases increased since the formation of the CU. As Section 3.2.1 indicates, this is significantly so in the case of sugar and meat for example.

### 1.1.2 Institutional requirements

As with the other Association Agreements negotiated by the EU, the institutional requirements of the EU-Turkey CU are set out to establish equal representation of the parties. Article 23 of the Ankara Agreement requires that the Association Council shall consist of members of the Governments of the Member States and members of the Council and of the Commission of the Community on the one hand and of members of the Turkish Government on the other. The CU requires i) an association council, ii) an association committee and iii) a parliamentary committee are established by the completion of the CU in 1996. The Association Agreement requires the Association Council to act unanimously. Given there is equal representation of each party, both parties possess the right to veto any decision. However, the composition and the functioning rules of the decision-making organ of the treaty – the Association Council – preclude representation by individual EU Member States, preventing internal EU Member States' dissonance from emerging during decision-making.

The Parliamentary Committee set up under the Agreement serves to 'ensure that everything functions well' within the CU. Its mandate is to carry out exchange of views and information, formulate recommendations to the Association Council and deliver opinions with a view to ensuring the proper functioning of the customs union. Further, 'the Parties shall consult within the Committee on any point relating to the implementation of the customs union decision which gives rise to a difficulty for either of them'. This means that there is no provision for either a competent jurisdiction or a similar institution to the European Commission that could independently monitor implementation or address weaknesses identified by the Parliamentary Committee. At the limit, this structure has been considered by Neuwahl (1999) to be an 'institutional void' denoting not so much to a lack of institutional structure for the

<sup>2</sup> Decision No. 1/95 Article 3.

implementation of the agreements but rather its diplomatic or intergovernmental character. This structure translates, in practice, into a lack of parliamentary control and an absence of recourse to judicial dispute settlement. Again, this presents a structure out of line with both EU and international norms and guidelines on transparency and inclusive governance. For example, the WTO dispute settlement mechanism (DMS) is based on clearly-defined rules – the WTO Dispute Settlement Understanding, with clear timetables for completing a case. First rulings are made by a panel and then either endorsed or rejected by the WTO's full membership. Subsequently, appeals that are based on points of law are also possible. The dispute settlement mechanism in the EU-Korea RTA is based on the WTO DSM but its procedures are faster. If consultations between the parties fail to reach a solution, the dispute is referred to an arbitration panel composed of 3 experts agreed to by the parties. After receiving the parties' submissions, the panel holds a hearing that is open to the public, with opportunities for third parties to inform the panel through *amicus curiae* submissions. The Panel must normally rule within 120 days and its findings are binding. The following section highlights the stark differences between these DSM's with the EU-Turkey CU.

### 1.1.3 Dispute settlement

In the event that a diplomatic solution to a difference concerning the operation of the CU cannot be found, there are theoretically three judicial methods available to settle disputes. For those related to the application or the interpretation of the agreement, the Court of Justice (CoJ) is potentially available. The Association Council must however take a unanimous decision to submit the dispute to the Court, again providing each party with the right to veto. Turkey may be reluctant to accept that the internal court of the EU would be wholly objective or impartial in settling disputes concerning the application and the interpretation of the Ankara Agreement. Indeed, the Association Council has not so far referred any dispute to be settled by the court of Justice of the European Union (CJEC). Nor has it utilised either of the other two options of submitting disputes to another existing unnamed court or tribunal or to arbitration.

Decision 1/95 permits, for a limited number of cases, the rules and modalities of the establishment of an arbitral tribunal to which the contracting parties can submit the dispute during the definitive stage of the CU. Under the provisions of Article 61, if the Association Council fails to settle a dispute relating to the scope or duration of protection measures in an area of direct relevance to the functioning of the Customs Union, and which cause or threaten to cause impairment of the free movement of goods or deflections of trade or safeguard measures<sup>3</sup> or rebalancing measures,<sup>4</sup> then either Party may refer the dispute to arbitration within six months of the date on which the procedure was initiated. A dispute referred to arbitration requires three arbitrators appointed within two months, including one umpire selected from a list drawn up by the Association Council. The arbitration tribunal sits in Brussels and must take its decisions by majority.<sup>5</sup>

Yet the enforcement of these decisions is limited by Article 25 of the Association Agreement which states each party shall be required to take the measures necessary to comply with the decisions, yet it does not provide for sanctions or remedies concerning non-compliance with these decisions. This could be a source of further disputes, when for example, a measure held to be in breach of the CU is not removed because there is little fear of punitive damages from continual non-compliance. The lack of remedies under the CU could operate to detract from using the dispute settlement mechanism to remove other unnecessary trade irritants in other non-tariff areas, such as TBT or customs requirements.

<sup>3</sup> Taken in accordance with Decision No. 1/95 Article 63

<sup>4</sup> Taken in accordance with Decision No. 1/95 Article 64

<sup>5</sup> Pursuant to Decision No. 1/95 Article 62



### 1.1.4 Excluded sectors

As asserted, it is becoming increasingly significant that Turkey and the EU still do not have a treaty framework that binds market access services commitments, nor those covering the temporary movement of service providers, commercial presence or investment. With regard to public procurement, Decision 1/95 only pledged future negotiations and given that Turkey is not a signatory to the World Trade Organization's (WTO) Agreement on Government Procurement, it is not a beneficiary of the EU's commitments under that regime. Although intellectual property rights and obligations are treated by Decision 1/95, there is still an entire field of geographical indications (GIs) that is absent. This subject is notably present and accounted for in all the new EU trade agreements. The same can be said for trade, investment and sustainable development issues. In the EU-Canada RTA, for example, there are comprehensive chapters dedicated to trade and sustainable development, trade and the environment, trade and labour. Moreover, these provisions are binding enforced by the dispute settlement mechanism attached to the 'trade and labour' provisions. In case of disagreement, a Party may request consultations in order to review the provisions for the resolution of disputes provided for, with a view to reach a mutually agreed position on the matter.

The overview provided in Table 3 confirms that with regard to the regulatory border and behind the border policies that are covered by the EU-Turkey CU, there are numerous divergences between this and the other deep integration agreements that the EU is currently negotiating and signing.

## 1.2 Regulatory border and behind-the-border policies

In addition to tariffs and related issues, the EU-Turkey CU requirements extend to rules and disciplines on various regulatory border and behind-the-border policies, such as customs modernisation, eliminating technical barriers to trade (TBTs), competition policies, intellectual property rights, and trade defence instruments. These are non-tariff barriers to the free movement of goods under the EU-Turkey CU. They are becoming increasingly more significant as the MFN tariff rates are progressively reduced. The following section looks at the specific policies in turn.

### 1.2.1 Customs reform

Prior to the formation of the CU, the import regime operating between the EU and Turkey was complex. EU goods accessing the Turkish market, faced a tradition paper based customs administration where declarants had to go to customs offices to register declarations. Since almost all shipments had to be physically inspected, the process at customs was very intrusive and time consuming. It often led traders to pay substantial facilitation money to speed up the process or to curry favour with customs officials in charge of their inspections. With the support of the World Bank, in 1995 Turkey began to modernise its customs administration, to speed up the release of goods, collect customs duties and related charges effectively, rationalise the clearance process, and simplify procedures while enhancing customs control and creating and transferring statistical data in a timely and reliable manner. The focus of the project was on modifying customs legislation according to CU requirements and the requirements of international customs standards developed by organisations such as the World Customs Organization. Other aims included developing and implementing computer systems and reorganising customs administration by creating a balance between customs control and trade facilitation in harmony with other international agreements and conventions that Turkey is party to.

The EU Customs Code<sup>6</sup> has been amended several times since 1992. It compiles the rules, arrangements and procedures applicable to goods traded between the European Community (EC) and non-member

<sup>6</sup> Regulation (EU) No 952/2013 of the European Parliament and of the Council of 9 October 2013 laying down the Union Customs Code (recast).

countries. As a single act covering the scope, definitions, basic provisions and content of Community customs law, it provides increased transparency. The Amendments to the Code have aimed to simplify and increase efficiency in its implementation, improve the rules on transit, security, preventing fraud and facilitating electronic declarations through granting Approved Economic Operator status and the one stop shop for importers and exporters. Following the Lisbon Treaty, the Commission adopted a proposal aimed at simplifying the legislation and administrative procedures governing imports and exports, creating a simple, paper-free environment for customs and trade and an electronic Community customs environment. As a result, Turkey has had to ensure that the necessary implementation and enforcement capacities, including links to the relevant EU computerised customs systems are up to date and, in place so that special rules laid down in related areas of the *acquis* could be followed. With the CU, Turkey adopted a new customs law similar to the EC's Customs Code, and as part of its trade facilitation work the Turkish Customs Administration (TCA) developed its ability to undertake its control function without the need to open every cargo shipment yet retain effective control over the flow of goods and duties payable. Over time Turkey has progressively achieved all of these goals.

EU trade strategy is served by further internationalisation of EU customs procedures through Turkey's harmonisation with the Customs Code. Harmonisation promotes simplicity and consistency of rules of origin and enhances cooperation between customs authorities, to ensure the most efficient electronic systems including electronic payments. It supports the European Commission's Trade for all strategy for 'enhanced partnerships' to extend and reinforce the current 'market access partnership' beyond the removal of obstacles to trade and investment, including customs cooperation activities, trade facilitation and sustainable development; and support the economic activities of SMEs.<sup>7</sup>

### 1.2.2 Technical barriers to trade

On the elimination of technical barriers to trade (TBTs) the EU's consistent position is that transparency and predictability of the regulatory and standard-setting process is key to trade and growth in general. It has therefore been a strong advocate, in the TBT Committee, for improving regulatory and standardisation practices of WTO Members, in particular through the application of principles of transparency and good regulatory practice at all stages of the regulatory and standard-setting process as well as convergence to international standards. The EU has also increasingly adopted a risk-oriented approach in deciding what conformity assessment procedures should be used for assessing compliance of products. This further improves the implementation of transparency provisions to aid communication with trade partners on regulatory initiatives that might influence trade.

There are essentially two ways to eliminate TBTs: harmonisation and mutual recognition. Since the establishment of the CU, Turkey has harmonised its standards with European and international ones. In addition, Turkey has harmonised its technical legislation with that of the EU, particularly in the New Approach area.<sup>8</sup> Harmonisation of the legislation in the Old Approach area, however, is still incomplete. Furthermore, Turkey has established the quality infrastructure comparable to the EU's, encompassing the operators and operation of standardisation, testing, certification, inspection, accreditation and

<sup>7</sup> See European Commission Report: Trade for all - Towards a more responsible trade and investment policy. 2015 p15.

<sup>8</sup> For the elimination of TBTs the EU, starting from 1960s until about the mid-1980s, has adopted the so called 'Old Approach', which aimed to achieve the harmonization of product norms in as much detail as possible. But it was emphasized by various economists that the Old Approach was slow, burdensome and unable to cope with the extensive variety of products which characterize modern economies. As a result, the EU adopted the 'New Approach' which limited the harmonization to 'essential requirements' for protecting the common public interest in health, safety and environment. The process of specification of these essential requirements in technical standards is left to European standardization bodies such as the European Committee for Standardization (CEN), European Committee for Electrotechnical Standardization (CENELEC) and European Telecommunications Standards Institute (ETSI).



metrology. Finally, Turkey took the necessary measures to develop the market surveillance and import control system as in the EU.

In areas where the elimination of TBTs requires the adoption of mutual recognition approach, an EU Member State of destination has to allow Turkish products free access to its market, as long as the products provide an equivalent level of protection of the various legitimate interests involved.<sup>9</sup> The same applies for products originating in an EU Member State, destined for Turkey. Both Turkey and the EU Member State of destination have the right to verify the equivalence of the level of protection provided by the product under scrutiny as compared to that provided by its own national rules. This is not a burden for products of EU origin, because as discussed above, EU product standards are based on international norms and risk assessments. However, in order to avoid the verification processes by EU Member State of destination, Turkey has to establish trust in its system of standards and conformity assessment procedures. As a result, the mutual recognition approach requires a relatively high degree of harmonised standards and testing procedures between the EU and Turkey.

Until the formation of the CU, Turkey had neither the infrastructure nor the required technical knowledge required for the elimination of TBTs. In the 20 years that have passed since the establishment of the CU, Turkey has harmonised in the case of industrial goods its product standards to a very large extent with European and international ones; harmonised its technical legislation with that of the EU; established quality infrastructure comparable to the EU's; and developed a market surveillance and import control system as in the EU. These are remarkable achievements. However there are still areas where Turkey needs further alignment of its legislation and implementation with the *acquis* as emphasised recently by the European Commission (2015).

### 1.2.3 Competition policy

Competition laws and policies are important to underpin market liberalisation. Competition refers to inter-firm rivalry in markets, and is vital to ensure that consumers enjoy freedom of choice, low prices, and good value for money, while also serving as an important driver of innovation and productivity improvement. Competition makes important, ongoing contributions to the welfare of citizens. Without effective comprehensive competition policies, markets can be dominated by monopolies or cartels that can undermine the benefits of competition for consumers and businesses, particularly small and medium sized enterprises.

Treaty-level provisions to safeguard competition were initially introduced in the European Coal and Steel Community in 1951. Ensuring undistorted competition was entrenched as a specific objective under the 1957 Treaty of Rome. Alongside core provisions on cartels and abuse of dominance and merger control provisions, EU competition policy was unprecedented in incorporating rules to deal with the competition-distorting effects of state aid or subsidies, as well as to address barriers to competition resulting from government. The Treaty insulated competition law enforcement from political control by putting the decision making of the Commission under the jurisdictional control of the Court of Justice.

Unlike the EU, until the adoption of the EU-Turkey CU, Turkey had no specific competition legislation and thus no competition policy enforcement. The agreement required Turkey to adopt EU competition rules, including measures regarding public aid. As a result, Turkey adopted the Law on the Protection of Competition, and established a Competition Authority (CA), aiming to ensure the formation and development of markets for goods and services in a free and sound competitive environment, observe the implementation of the Competition Law, and fulfil the duties assigned to it by the law. The CA has played an important role in moving the Turkish economy towards greater reliance on competition-based

<sup>9</sup> Pursuant to Communication 2003/C265/02.

and consumer-welfare-oriented market mechanisms. Turkey has shown significant progress on anti-trust issues, and the CA has a clear track record on implementing competition rules.

Article 34 of the Customs Union Decision 1/95 prohibits Turkey and EU Member States from providing state resources to aid industrial goods in undertakings or industrial sectors where doing so distorts or threatens to distort competition between the EU and Turkey. Under the requirements of Article 39(2), Turkey must adapt all of its existing aid schemes to EU standards and comply with the notification and guideline procedures established by the EU to control aid provided by Member States. Although the law on State aid and subsidies was passed by Parliament in October 2010 the EU State Aid rules could still not be implemented because the implementing regulations have not been adopted. Thus, State aid is an area where Turkey needs further alignment of its legislation and implementation with the *acquis*.

#### 1.2.4 Intellectual property rights

Ideas and knowledge are an increasingly important part of trade. Most of the value of new medicines and other high technology products lies in the amount of invention, innovation, research, design and testing involved. Films, music recordings, books, computer software and on-line services are bought and sold because of the information and creativity they contain, not usually because of the plastic, metal or paper used to make them. Creators of ideas and knowledge can be given the right to prevent others from using their inventions, designs or other creations — and to use that right to negotiate payment in return for others using them. These are “intellectual property rights” (IPRs). They take a number of forms. For example books, paintings and films come under copyright; inventions can be patented; brand names and product logos can be registered as trademarks; and so on.

The EU actively seeks to promote IPRs on the basis that they support creativity and innovation in the EU that are intangible assets for European growth and competitiveness. It has been estimated that IPR-intensive sectors account for around 39 % of EU GDP (worth some EUR 4.7 trillion annually) and, taking indirect jobs into account, up to 35 % of all jobs.<sup>10</sup> Consequently, the effective enforcement of these rights both within and beyond the EU directly affects growth and employment in the EU. The EU is concerned that if IPRs are not adequately enforced, European ideas, brands and products can be pirated and counterfeited. Estimates suggest that the EU loses about EUR8 billion of its GDP a year because of counterfeiting and piracy.<sup>11</sup> This will not only impact on EU employment prospects, but also consumer health and safety generally. Therefore, the EU has been concerned to promulgate appropriate, transparent and predictable IPR legal regimes.<sup>12</sup> Intellectual property right-holders require access to effective ways of protecting their rights both domestically and internationally. Under EU policy, optimal and economically efficient IP infrastructure encompasses the legal recognition, registration, utilisation and balanced enforcement of all forms of IPRs.

Article 31 and Annex 8 of Decision 1/95 require that Turkey must ensure adequate protection and enforcement of intellectual property rights (IPR), have implemented the Uruguay Round Agreement on Trade-Related Aspects of Intellectual Property Rights (TRIPS) by 1999, adopt legislation by January 1, 1999 to secure the patentability of pharmaceutical products and processes, and accede to various international conventions on IPR specified in the CU Decision 1/95. While Turkey has made substantial efforts to align its legislation with the *acquis* since 1995, and the Turkish Patent Institute (TPI) was

<sup>10</sup> Intellectual property rights intensive industries: contribution to economic performance and employment in the European Union, Industry-Level Analysis Report, Joint project between the European Patent Office and the Office for Harmonisation in the Internal Market, Munich and Alicante, 2013.

<sup>11</sup> CEBR, The impact of counterfeiting on four main sectors in the European Union, Centre for Economic and Business Research, London, 2000.

<sup>12</sup> Trade, growth and intellectual property - Strategy for the protection and enforcement of intellectual property rights in third countries. Communication from the Commission to the European Parliament, the Council and the European Economic and Social Committee. SWD(2014) 204 final.

established in 1994, challenges remain which undermine the enforcement of EU IPR policies. The main problem with IPR in Turkey, however, is with the enforcing legislation, as it requires specific skills. Although a relatively large number of judges, lawyers, enforcement staff, police force members, and customs officers have been trained in IPR-related issues, more are needed. Turkey is aware of the fact that it has to provide the measures, procedures, and remedies necessary to ensure fair and equitable enforcement of IPR.

### 1.2.5 Trade defence instruments

An important obstacle for the liberalisation of trade in goods is the continued application of trade defence instruments (TDIs) such as anti-dumping and anti-subsidy measures. It is important to emphasise here that the use of such measures is contradictory to the principles of the Single Market. For example TDIs are not utilised in intra EU trade. In the EU-Turkey CU the use of TDIs were permitted in order to force the parties in particular Turkey to observe the rules of the CU such as rules on elimination of TBTs, competition policy and IPRs. But to minimise the detrimental effects of TDIs Turkey was required to approximate and implement the EU's common commercial policy regulations, including procedures for anti-dumping, countervailing duties, surveillance, and safeguards measures, as well as administering quantitative quotas and procedures for officially supported export credits. Since the formation of the CU, Turkey has successfully adopted all related EU rules and regulations and is effectively implementing them. But as emphasised by the World Bank (2014) both the EU and Turkey have made extensive use of TDIs threatening trade between the parties. It is emphasised that greater cooperation is needed between the EU and Turkey to ensure continued détente in the use of the TDIs.

## 1.3 Quantitative analysis of the EU-Turkey Customs Union

This section briefly considers EU-Turkish trade performance prior to the formation of the CU and thereafter, Turkish foreign direct investment (FDI) performance prior to the establishment of the CU and thereafter, and quantitative studies of the EU-Turkey CU.

The CU has had positive effects both for the EU and Turkey. Prior to the formation of the CU, Turkey's economy wide nominal protection rate (NPR) in trade with the EU amounted to 10.2 % and in trade with third countries 22.1 % (Togan, 1997). With the formation of the CU, NPRs decreased substantially in almost all sectors. The economy-wide NPR during 2001 in trade with the EU amounted to 1.3 %, and in the case of trade with third countries, the average NPR amounted to 6.9 %. For example, the average NPR decreased from 22.1 % to 1.3 % for Israel and Central and Eastern European countries that the EU had FTAs with. For developing countries that are granted generalised system of preferences (GSP) treatment, the average NPR decreased from 22.1 % in 1994 to 2.7 % in 2001. Finally, for countries like the US, Japan, and Canada, for which the EU applies most favoured nation (MFN) tariffs, average NPR decreased from 22.1 % in 1994 to 6.9 % in 2001. Thus, regarding access to the Turkish market, almost all countries in the world have benefited from NPR reductions in Turkey. Regarding access of Turkish goods to the EU market, the EU had abolished nominal tariff rates on imports of industrial goods from Turkey on September 1, 1971.

From the EU perspective, the rise in FDI to Turkey from the EU has been significant along with the deeper integration between Turkish and European firms along production networks. Trade and investment linkages between the EU and Turkey have deepened reaching USD147 billion in 2012 making Turkey the EU's sixth largest trading partner and the EU Turkey's biggest. The EU is the largest foreign investor in Turkey, accounting for three-quarters of total foreign direct investment (FDI) inflows during the last five years. Foreign investment into Turkey is mostly for services and manufacturing. The largest investors include Bosch, Mercedes and Toyota. However, investments in agro-processing are significant and growing, accounting for 7 per cent of FDI inflows since 2007. Nevertheless, as discussed below, FDI into Turkey remains low compared to other fast growing emerging markets.

The CU has brought greater benefits than an FTA between the EU and Turkey would have because it has provided an anchor on Turkey's applied tariffs for industrial products and negated the need for rules of origin on bilateral trade. However, as emphasised below, the CU has not caused a major shift in relative trade shares for Turkey because the EU had already opened its markets for Turkish exports of industrial goods long before the CU came into effect. Estimates suggest that EU exports to Turkey would have been 4.2 per cent lower if the rules of origin were more restrictive and Turkey maintained its MFN tariffs for industrial products at current levels. Moreover, the CU has also coincided with more deeply integrated production networks between Turkish and EU firms, particularly in the automobiles and clothing sectors. Consequently, intra-industry trade between Turkey and the EU has increased from 30 per cent in 1990 to over 50 per cent. The reduction in trade costs associated with the CU, including the harmonisation of standards and elimination of rules of origin is likely to have promoted growing intra-industry trade along global value chains, which are known to be particularly sensitive to trade costs.

### 1.3.1 Trade performance

Table 1 shows the developments in EU and Turkish trade prior to and after the formation of the CU. In 1995 Turkish exports of agricultural and industrial products to the EU-28 amounted to USD12.2 billion (56.3 % of Turkey's exports); while imports of agricultural and industrial products from the EU-28 amounted to USD18 billion (50.4 % of Turkey's imports).<sup>13</sup> With the formation of the CU the share of imports from the EU-28 in total imports went up from 50.4 % in 1995 to 55.8% in 1996, fluctuated around 54.2 % during the period 1997-2000, and then declined considerably over the period 2001-2008 reaching 36.9 % in 2008. By 2014 the share of imports from the EU in total imports stood at 36.7 %. On the other hand, the share of exports to the EU-28 in total exports declined as shown in Figure 1 from 56.3 % in 1995 to 51.3 % in 1997 and increased to 58.1 % in 1999, but thereafter the share fluctuated during the period 2000-2007 around 57 %, and started to decline thereafter. By 2014 the share of exports to the EU in total exports had reached to 43.5 %. Finally, note that the share of EU exports to Turkey in total EU exports as shown in Figure 2 has increased 0.67 % in 1995 to 0.94 % in 1997, declined to 0.65 % in 2001, increased thereafter reaching 1.21 % in 2011, and declined afterwards to 1.11 % in 2014. On the other hand, the share of EU imports from Turkey in total EU imports has increased 0.48 % in 1995 to 0.54 % in 1998, declined to 0.53 % in 2000, increased thereafter reaching 0.91 % in 2007, declined to 0.82 % in 2009, reaching 1.11 % in 2014.

<sup>13</sup> In 1958 Belgium, France, Germany, Italy, Luxembourg and Netherlands became members of the European Economic Community (EEC) that was formed by the Treaty of Rome in 1957. In 1973 Denmark, Ireland and United Kingdom joined the European Community (EC); Greece joined the EC in 1981; Spain and Portugal joined the EC in 1986; Austria, Finland and Sweden joined the EU in 1995; Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, and Slovenia joined the EU in 2004; Bulgaria and Romania became members of the EU in 2007; and Croatia joined the EU in 2013. Although in 1990 16 of the above mentioned members were not members of the EC we consider in the following for reasons of consistency data for EU-28 consisting of Austria, Belgium, Denmark, Finland, France, Germany, Greece, Ireland, Italy, Luxembourg, Netherlands, Portugal, Spain, Sweden, United Kingdom, Cyprus, Czech Republic, Estonia, Hungary, Latvia, Lithuania, Malta, Poland, Slovakia, Slovenia, and Croatia over the entire period 1990-2014.

**Figure 1**

Comparison of the growth rate of EU-28 exports to Turkey prior to the formation of the CU with those observed after the formation of the CU reveals that the average growth rate of exports from the EU-28 has declined from 9.1 % experienced during 1990-1995 to -2.5 % during the period 1996-2001, but thereafter picked up and increased to 16.9 % over the period 2002-2008. During 2010-2014 the average growth rate of exports from the EU-28 into Turkey amounted to 4.2 %. On the other hand the effect of the CU on exports seems also to be of limited importance initially. Whereas the annual average growth rate of exports to the EU-28 was 8.5 % prior to the formation of the CU, it had declined to 6.2 % over the period 1996-2001, but increased thereafter to 18.8 % over the period 2002-2008. The average growth rate of exports to EU-28 over the period 2010-2014 declined to 5.2 %.

Table 1: EU-Turkey Foreign Trade, 1990-2014

	Total Turkish Exports (million US\$)	Total Turkish Imports (million US\$)	Total EU Exports (million US\$)	Total EU Imports (million US\$)	Turkish Exports to the EU-28 (million US\$)	Turkish Imports from the EU-28 (million US\$)	Share of Turkish Exports to the EU-28 in Total Turkish Exports	Share of Turkish Imports from the EU-28 in Total Turkish Imports	Share of EU Exports to Turkey in total Exports of the EU	Share of EU Imports from Turkey in total Imports of the EU
1990	12,959	22,302	1,893,598	1,934,975	7,468	10,595	57.63	47.51	0.56	0.39
1991	13,593	21,047	1,944,333	1,967,626	7,769	10,676	57.15	50.73	0.55	0.39
1992	14,715	22,871	2,103,607	2,114,564	8,446	11,511	57.40	50.33	0.55	0.40
1993	15,345	29,428	1,951,611	1,871,246	8,237	14,922	53.68	50.71	0.76	0.44
1994	18,106	23,270	2,189,103	2,087,844	9,376	11,643	51.79	50.04	0.53	0.45
1995	21,637	35,709	2,681,725	2,540,495	12,188	18,006	56.33	50.43	0.67	0.48
1996	23,224	43,627	2,776,094	2,619,101	12,590	24,349	54.21	55.81	0.88	0.48
1997	26,261	48,559	2,782,151	2,613,171	13,471	26,128	51.30	53.81	0.94	0.52
1998	26,974	45,921	2,898,381	2,769,883	14,837	25,297	55.01	55.09	0.87	0.54
1999	26,587	40,671	2,920,600	2,840,970	15,454	22,538	58.13	55.41	0.77	0.54
2000	27,775	54,503	3,000,598	2,973,845	15,688	28,552	56.48	52.39	0.95	0.53
2001	31,334	41,399	3,038,280	2,968,087	17,576	19,841	56.09	47.93	0.65	0.59
2002	36,059	51,554	3,246,128	3,108,349	20,458	25,698	56.73	49.85	0.79	0.66
2003	47,253	69,340	3,877,665	3,744,750	27,479	35,157	58.15	50.70	0.91	0.73
2004	63,167	97,540	4,657,962	4,494,103	36,699	48,131	58.10	49.34	1.03	0.82
2005	73,476	116,774	5,070,699	4,961,898	41,533	52,781	56.53	45.20	1.04	0.84
2006	85,535	139,576	5,738,246	5,668,885	48,149	59,448	56.29	42.59	1.04	0.85
2007	107,272	170,057	6,742,668	6,642,268	60,754	68,472	56.64	40.26	1.02	0.91
2008	132,027	201,964	7,433,753	7,405,863	63,719	74,513	48.26	36.89	1.00	0.86
2009	102,143	140,928	5,934,715	5,771,649	47,228	56,616	46.24	40.17	0.95	0.82
2010	113,883	185,544	6,539,073	6,399,072	52,934	72,391	46.48	39.02	1.11	0.83
2011	134,907	240,842	7,584,829	7,395,957	62,589	91,439	46.39	37.97	1.21	0.85
2012	152,462	236,545	7,347,136	7,014,295	59,398	87,657	38.96	37.06	1.19	0.85
2013	151,803	251,661	7,709,920	7,238,018	63,040	92,458	41.53	36.74	1.20	0.87
2014	157,617	242,177	7,977,474	7,464,410	68,514	88,784	43.47	36.66	1.11	0.92

Source: Turkish Statistical Institute and World Development Indicators



**Figure 2**

Comparison of the growth rate of exports from the EU-28 into Turkey prior to the formation of the CU with those observed after the formation of the CU reveals that the average growth rate of imports from the EU-28 has declined from 9.1 % experienced during 1990-1995 to -2.5 % during the period 1996-2001, but thereafter picked up and increased to 16.9 % over the period 2002-2008. During 2010-2014 the average growth rate of imports from the EU-28 amounted to 4.2 %. On the other hand the effect of the CU on exports seems also to be of limited importance initially. Whereas the annual average growth rate of exports to the EU-28 was 8.5 % prior to the formation of the CU, it had declined to 6.2 % over the period 1996-2001, but increased thereafter to 18.8 % over the period 2002-2008. The average growth rate of exports to EU-28 over the period 2010-2014 declined to 5.2 %.

### 1.3.2 Foreign direct investment

Despite its location and natural advantage, Turkey was generally fairly unsuccessful in attracting stable inflows of foreign direct investment (FDI) from abroad. During the period 1990-1995, total annual FDI into Turkey inflows amounted to only USD745 million, as shown in Table 2. The country's failure to attract large foreign investment inflows was mainly due to economic and political uncertainties surrounding the country and the enormous institutional, legal and judicial obstacles faced by foreign investors in Turkey. Foreign-owned firms had been subject to special authorisations and sectoral limitations. According to the Foreign Investment Advisory Service (2001a, 2001b) seven major problems impeded the operations of FDI enterprises up until the early 2000s: (i) political instability, (ii) government hassle, (iii) a weak judicial system, (iv) heavy taxation, (v) corruption, (vi) deficient infrastructure and (vii) competition from the informal economy.

During the period 1996-2000 annual average FDI inflows only increased slightly, amounting to USD846 million, showing no immediate substantial increase in FDI inflows after the formation of the CU. However, this may be attributable to global trends and in particular emerging market financial crises, rather than any defect on the part of the CU. The FDI inflows started to increase only after 2001, and reached USD20.2 billion in 2006, USD22 billion in 2007 and USD19.9 billion in 2008. This considerable increase in FDI inflows seems to be due mainly the EU's 2004 decision to begin membership negotiations with Turkey, liberalisation measures introduced during the period after the 2001 crisis and implementation of the privatisation program after 2002. During 2009 FDI inflow decreased to USD8.6 billion and attained a value of USD9 billion during 2010 due to the financial crisis. Finally, during the period 2011-2014 it has fluctuated around the average value of USD13.7 billion.

Table 2: Foreign Direct Investment, 1990-2014

	Total FDI Inflow to Turkey (million US\$)	FDI Inflow from the EU countries to Turkey (million US\$)	Total FDI Outflow from the EU (million US\$)	Share of FDI from the EU countries to Turkey in total FDI inflow to Turkey	Share of FDI from the EU countries to Turkey in total FDI outflow from the EU
1990	684	NA	132,184	NA	NA
1991	810	NA	107,334	NA	NA
1992	844	NA	105,017	NA	NA
1993	636	NA	93,843	NA	NA
1994	608	NA	120,745	NA	NA
1995	885	NA	157,818	NA	NA
1996	722	NA	182,279	NA	NA
1997	805	NA	226,010	NA	NA
1998	940	NA	421,815	NA	NA
1999	783	NA	728,140	NA	NA
2000	982	NA	793,657	NA	NA
2001	3,352	NA	294,473	NA	NA
2002	1,082	455	234,469	42.05	0.19
2003	1,702	565	260,956	33.20	0.22
2004	2,785	1,027	346,119	36.88	0.30
2005	10,031	5,006	530,741	49.91	0.94
2006	20,185	14,489	652,271	71.78	2.22
2007	22,047	12,601	1,182,922	57.16	1.07
2008	19,851	11,077	743,403	55.80	1.49
2009	8,585	4,942	352,388	57.57	1.40
2010	9,099	4,737	459,366	52.06	1.03
2011	16,176	11,495	519,862	71.06	2.21
2012	13,282	7,303	316,726	54.98	2.31
2013	12,457	5,272	285,133	42.32	1.85
2014	12,763	5,517	280,124	43.23	1.97

Source: Central Bank of the Republic of Turkey and UNCTAD

Although we have data on total FDI inflows collected by the Central Bank of the Republic of Turkey over the period 1990-2014, data on FDI inflows from the EU started to be collected only relatively recently (in 2002). Table 2 reveals that total FDI inflow has grown during the period 1990-1995 at an annual rate of 0.4 %. After the formation of the CU the growth rate of FDI inflow during the period 1996-2000 increased to 5.9 %, but then decreased to -1 % during the period 2001-2004. After increasing at the annual rate of 21.4 % during the period 2005-2008, the rate of growth of FDI inflows decreased to -7.8 % during the period 2011-2014, reflecting the impact of the financial crisis. On the other hand, consideration of the share of FDI inflows from the EU countries in total FDI inflows into Turkey reveals that the share has fluctuated during the period 2002-2014 between 33.2 % and 71.8 %. As of 2014 the share of FDI inflows from the EU countries into Turkey in total FDI inflows into Turkey amounted to 43.2 %.

Similarly, the share of FDI from the EU countries to Turkey in total FDI outflows from the EU has fluctuated between 0.19 % (2002) and 2.32 % (2012), and as of 2014 the share of FDI from the EU countries to Turkey in total FDI outflows from the EU amounted to 1.97 %. The annual growth rate of FDI inflows from EU countries has decreased from 79.8 % during 2002-2008 to -25.3 % during 2011- 2014. These developments could be explained by the change in perception of EU investors about course of Turkish accession negotiations. Initially, the perception was that Turkey's investment climate would improve over time as accession negotiation progressed. But this perception changed over time as can be seen from Table 2. The various international competitiveness studies like the Doing Business Survey of the World Bank did also not reflect an improvement in Turkish investment climate, and in 2016 Doing Business Survey Turkey is still ranked as the 55th country among 189 countries.



### 1.3.3 Impact of the EU-Turkey Customs Union

The existing literature on the effects of the EU-Turkey CU has focused on the one hand on ex-ante studies and on the other hand on ex-post studies. While the ex-ante studies are of computable general equilibrium (CGE) type, ex-post studies use mostly the gravity model to assess the impact of the CU on trade and welfare.

One of the earliest ex-ante studies of the EU-Turkey CU is that by Harrison et al. (1997). Using a CGE model the authors conclude that the CU generates welfare gains for Turkey of 1-1.5 % of its GDP. On the other hand, Lejour and de Mooij (2005) estimate the effects of the EU-Turkey CU for both the EU countries and Turkey. On the basis of a CGE model for the world economy, the authors find the agricultural, textile and apparel sectors would suffer a small decline in the EU countries, whereas the chemicals, metals and transport equipment sectors were predicted to expand marginally in the EU countries. Overall they suggest that the effects of Turkey's accession to the single market are substantial and positive for Turkey, small but positive for mainly the Central and Eastern European (CEE) countries that have acceded to the EU in 2004, and negligible for the EU-15.

Among the ex-post studies of the EU-Turkey CU two recent studies are of major importance. The World Bank (2014) estimates a gravity model using a dummy variable for the EU-Turkey CU. The coefficient estimate was 0.2 suggesting a 22 % increase in bilateral trade due to CU, though this effect was not statistically significant. On the other hand, Magee (2015) concludes that the CU has generated more than twice as much trade creation as trade diversion, but that the overall impact of the CU has been relatively small.<sup>14</sup> The World Bank report further notes that the CU has coincided with more deeply integrated production networks between Turkish and EU firms, particularly in the automobiles and clothing sectors. Consequently, intra-industry trade between Turkey and the EU has increased from 30 per cent in 1990 to over 50 per cent. The reduction in trade costs associated with the CU, including the harmonisation of standards and elimination of rules of origin is likely to have promoted growing intra-industry trade along global value chains, which are known to be particularly sensitive to trade costs.

<sup>14</sup> A regional trade agreement (RTA) creates a preference favoring trade with an RTA partner country, whose imports face no tariffs, over other countries whose imports are taxed. When imports from low-cost countries outside the regional trading area are replaced by imports from higher cost countries within the RTA, we talk of trade diversion. On the other hand, trade creation is generated when the lower tariffs within the trading block allow inefficient domestic production to be replaced by cheaper imports from a preferential trading partner.

## 2 Evaluating the EU-Turkey Customs Union

As Chapter 1 highlighted, the EU-Turkey CU of 1995 has been a major instrument of integration into the EU and global markets for Turkey, offering the country powerful tools to reform its economy. It has credibly locked Turkey into a liberal foreign trade regime for industrial goods. As a result, Turkish producers of industrial goods have become exposed to competition from imports and they operate within one of the largest FTAs for industrial products in the world. They are protected by tariffs from external competition to exactly the same extent that EU producers are, and as such, face competition from duty-free imports of industrial goods from world-class pan-European firms. In return, Turkish industrial producers have duty-free market access to the European Economic Area.

But the EU-Turkey CU has not been without its critics. Akman (2010) points out the following problems:

- i) The EU has its own priorities reflected in its FTAs that are concluded, and these agreements do not take into account Turkey's special interests.
- ii) Turkey suffers tariff revenue losses. In particular, imports from third countries by way of trade deflection via the EU induce tariff revenue losses for Turkey.
- iii) Turkey cannot enter into FTAs with third countries with which the EU has not accorded a deal.<sup>15</sup>
- iv) There are latecomer effects. In particular, Turkey can conclude FTAs only after the EU has concluded the FTAs. This puts Turkish exporters into disadvantageous position with regards to EU exporters, who can obtain preferential status by penetrating into third country markets several years earlier.
- v) Some of EU's trade partners that had concluded FTAs with the EU or continue to negotiate FTAs with the EU refrain from concluding FTAs with Turkey despite the 'Turkey Clause' included in FTAs concluded by the EU.<sup>16</sup>

The World Bank (2014) considers in addition to the criticisms stated above the following problems:

- a. The road transport quotas and transit permits hinder the free circulation of goods covered by the CU.
- b. The use of Trade Defence Instruments such as anti-dumping and safeguard measures harms trade.
- c. The current visa regime has repercussions on EU-Turkey trade and business relationships.

On the other hand, the European Commission (2015) criticises not the CU per se, but rather the slow progress achieved by Turkey in fulfilling the requirements of the CU. In particular it points out that some TBTs delay or prevent the free movement of goods in violation of Turkey's obligations under the CU; that Turkey needs to implement state aid law without further delay to ensure effective monitoring of aid schemes and proper alignment with the *acquis*; that Turkey needs to improve enforcement measures in fight against piracy and counterfeiting; and that Turkey has to remove import and export restrictions preventing the effective free movement of goods.

<sup>15</sup> See legal discussion in section 2.1 below.

<sup>16</sup> The Turkey Clause has been included in EU FTAs to signal the intention for EU FTA partners to start negotiating a FTA with Turkey on the basis of the findings of a joint feasibility study, however, but it cannot force third countries to conclude a negotiation with Turkey. It was first used in the EU's negotiations with Algeria in 2005.

## 2.1 Strengths and weaknesses: The legal framework

The framework of the CU offers incentives to Turkey to align with EU law due to its implicit hint of a further accession process, yet there are no explicit provisions in the CU to bind commitments beyond the trade in industrial goods on the part of the EU. Nevertheless, as noted in Section 1.2, due to the separate track under the accession process, Turkey's actual alignment to EU internal market law has advanced in certain areas, such as free movement of goods, competition policy and State aid, energy, economic and monetary policy, enterprise and industrial policy, as well as in consumer protection, statistics, Trans-European Networks, and science and research. Yet there have been various delays in opening new chapters for negotiation under the accession process. There are clear political, economic and legal dimensions to the structure of the CU plan. As a result association law is not unified under one regime, rather it is made up of different legal principles derived from different primary and secondary association rules along with various and interpretations set out in CJEU case law.

This section identifies poor rules alignment as well as any legal challenges caused by the growing reality gap between this static legal framework and a dynamic modern economy. It divides this analysis into 'internal' and 'external' legal requirements.

### 2.1.1 Internal requirements of EU-Turkey Customs Union

While commercial agreements between the EU and third parties are explicitly provided by Article 207 of the Treaty on the Functioning of the EU (TFEU), the association agreements, such as with Turkey, have been concluded under the broader and more flexible wording provided for under Article 217. This provision can provide for deeper integration agreements extending beyond purely commercial purposes such as those with economic, social, political and cultural relations, as well as agreements that adopt CU. Thus the Turkish association agreement aimed to achieve a CU over three stages and alignment to the four freedoms with the long-term goal of preparing Turkey for accession. However, to recall, it does not provide a binding roadmap for accession.

As noted above, Association law is not a single regime, rather it consists of different layers of legal principles made up from the Ankara Agreement, the Additional Protocol from 1970 and the Association Council Decisions 2/76, 1/80, 3/80 and 1/95. Since 1987, the CoJ has also been regularly called upon to rule on the legal implications of this body of EU-Turkey Association law. As a result, the Turkish association suffers from a case-by-case approach built on a static association initiated over 50 years ago. The EU institutions are not required to interpret the Ankara Agreement, the Additional Protocol from 1970 and the Association Council Decisions in the same dynamic teleological fashion as employed when interpreting the EU Treaty provisions. Further legal developments can only be achieved through novel Association Council Decisions specifying rights or drafting of a more dynamic legal framework such as an RTA (see Chapter 3 Options).

### 2.1.2 External requirements of GATT Article XXIV

The formation of preferential agreements is subject to the legal conditions set out under the GATT Article XXIV. Agreements such as the EU-Turkey CU must conform to the requirement to apply 'substantially the same' duties and other regulations of commerce to the trade of non-members. Consequently, although the EU does not have to align itself to Turkey's external agreements, it must still comply with GATT Article XXIV's CU requirements for a harmonised external regime. For its part, Turkey must take the necessary measures and negotiate agreements on a mutually advantageous basis with the countries concerned - in order to align its commercial policy for industrial goods with the EU's external FTA regimes.<sup>17</sup> A fault line

<sup>17</sup> Article 16 of Decision 1/95.

emerges however, because while under the CU Turkey is obliged to align with the preferential agreements that the Community signs with third countries, these third countries do not have any obligation to conclude such agreements with Turkey. Indeed, it is more advantageous for these countries not to conclude preferential agreements with Turkey because they already have access to the Turkish market through the EU-Turkey CU. However, if Turkey does not conclude agreements with third parties signing preferential agreements with the EU, Turkey must apply reduced or zero tariff rates for the imported products from these countries in order to comply with its obligations under the EU-Turkey CU.

To provide transitional adjustment support to Turkey, a compensatory levy provision was established for the first five years of the implementation of the CU.<sup>18</sup> This aimed at reducing Turkey's economic burden but it was a complicated calculation: Where Turkey maintained a tariff policy different from that of the Community, goods imported from third countries into the Community and released for free circulation with preferential treatment by reason of their country of origin or of exportation were subject to the payment of a compensatory levy imported into Turkey from countries to which the same preferential tariff treatment is not granted by Turkey and *inter alia*, the duty to be paid in Turkey is at least five percentage points higher than that applicable in the Community, and an important distortion of traffic related to these goods has been observed. The structural asymmetry and temporary and over-complicated compensatory instrument as set out under the CU framework and the Association Agreement served to undermine the EU-Turkey CU's perceived legitimacy. Turkey cannot take part in the negotiations between the EU and third countries' and moreover, neither can Turkey unilaterally apply new EU negotiated preferences to the trading partner since this would trigger violations of the GATT's cornerstone principle the most-favoured nation obligation (Mathis, 2013). Because countries inside and outside the region are treated differently and this may have a negative effect on countries outside the region. GATT Article XXIV prohibits exceptions to the MFN requirement unless tariffs and other barriers to trade are eliminated on substantially all trade within the region as long as they don't raise barriers to third parties.

In sum, the existing legal and institutional framework of the CU translates into an overall relationship of general dependency both economically and politically of Turkey upon the EU. Turkey is obliged to adopt a considerable part of the *acquis* in several fields and to align its custom and commercial legislation with the EU legislation, without involvement in the EU's external trade decision-making processes with regard to negotiating FTAs with third parties. Without setting out a binding roadmap to membership these systemic weaknesses undermine the legitimacy of the relationship and creates for Turkey a sovereignty shortfall. The obligation to align with the preferential agreements of the Community is coupled with the obligation not to participate to other free trade agreements.

<sup>18</sup> Ibid.

### 3 Recent developments in the world economy

This section assesses the international context in which the outmoded CU now operates. It postulates that, during the period when Turkey was trying to implement the requirements of the EU-Turkey CU, major changes were taking place in the world economy. Since the mid-1980s developments in telecom and internet have triggered a suite of information management innovations that made it easier and cheaper to coordinate complex production activities from a distance. As a result some production stages previously performed in close proximity were dispersed geographically.

Manufacturing today is increasingly managed through global value chains (GVC). While before 1985 successful industrialisation meant building a domestic supply chain, today developing countries join GVCs and grow rapidly because offshore production brings elements that took Germany and Korea decades to develop domestically. A good example is China. According to Baldwin (2013) the heart of GVC trade is an intertwining of trade in goods; international investment; and cross-border flow of knowhow. To benefit from increased GVC trade it is very important that tariffs are eliminated, transport cost and administrative costs are low, and delays do not occur. On the other hand, lower barriers to investment are a must for participating in GVC trade, as they facilitate investments by lead firms leading to integration of economies in international production networks. Furthermore, a high quality transport infrastructure with major international gateways and corridor infrastructures such as airports, harbours, railways and highways facilitates economies' participation in GVCs.

The industrial counties US, EU and Japan, noting that GVC trade is not global and rather regional, have decided to establish the rules of GVC trade regionally rather than multilaterally. They started to sign free trade agreements (FTA) with deep provisions that are pro GVC trade. They also signed Bilateral Investment Treaties (BIT) tackling different investment issues. As a result, the centrality of WTO in global trade governance started to erode. Recently, the US and the EU started to negotiate mega regionals such as the Trans-Pacific Partnership (TPP) and Trans-Atlantic Trade and Investment Partnership (TTIP). In addition, the EU and US have concluded deep and comprehensive FTAs with Korea, and EU with Canada. It seems that in the future, as emphasised by Baldwin (2014), WTO will continue governing the traditional trade while mega-regionals will set the rules in general for the 21st century international trade. Traditional trade refers to an economy in which goods made in one nation and sold to another. The rules of international trade after World War II were set first by General Agreement on Tariffs and Trade (GATT) and thereafter by World Trade Organization (WTO). This rule based trading system is based on norms that are almost universally accepted. Within WTO disputes are adjudicated by an international court whose rulings are almost universally implemented, membership to WTO is almost universal, and decisions at WTO are made by consensus.

The contemporary WTO framework provides a legal regulatory framework that extends beyond tariffs to subsidies in goods, services, intellectual property rights, government procurement and agriculture. However, developments in international trade and technology require solutions that move beyond the current negotiations. The current post-Nairobi Agenda is focused on agricultural subsidies than addressing issues raised by global value chains and the need for sustainable development strategies. Regional agreements are more flexible negotiating instruments that can more rapidly deployed to address the increased importance of services and the interlinkages between added value goods and services. Regional agreements are also better placed to include WTO+ frameworks that can manage the impact of trade and investment on labour standards, environmental management and sustainability. Specific bespoke measures can be established to address development interests such as increasing SME participation in the economy, and particularly procurement markets. As in the EU-Canada agreement, comprehensive chapters can be included to ensure trade and investment does not only lead to a lowering of social and environmental standards to attract interest, but also to promote the raising of standards, good governance and rules based approaches to development. In sum: while the WTO

continues to perform a pivotal role in regulating the traditional economy, the spread of multilateral rules to new areas such as GVC and sustainability, is clearly facing the challenges attached to concluding consensus based agreements among over 160 Members.

The following section provides an overview of the deeper integration agreements that are emerging to complement the multilateral trading system.

### 3.1 The arrival of deep integration agreements

Table 3 compares the scope and coverage of the TPP and TTIP among themselves as well as TPP and TTIP with the EU-Korea FTA (KOREU), Canada-EU Comprehensive Economic and Trade Agreement (CETA) and the EU-Ukraine Deep and Comprehensive Free Trade Area (DCFTA). Among these agreements TTIP will probably be the most comprehensive trade and investment agreement. Although at this time we do not have a text of the TTIP agreement, the EU Commission has made a large body of EU negotiating texts publically available.<sup>19</sup> On the other hand, Ministers of the TPP countries – Australia, Brunei Darussalam, Canada, Chile, Japan, Malaysia, Mexico, New Zealand, Peru, Singapore, United States, and Vietnam – announced on October 4, 2015 conclusion of their negotiations, and made the text of the agreement public.<sup>20</sup> Note that the KOREU was ratified on May 4, 2011, and that the Canada-EU summit on September 26, 2014 in Ottawa marked the end of the negotiations of the EU-Canada trade agreement. Finally, note that the EU and Ukraine signed the DCFTA on June 27, 2014 as part of their broader Association Agreement, and the EU and Ukraine started to apply the DCFTA on January 1, 2016.

**Table 3 Comparing the Scope and Coverage of TTIP, TPP, KOREU, CETA, and EU-Ukraine DCFTA**

	<b>TTIP</b>	<b>TPP</b>	<b>EU-Korea FTA</b>	<b>EU-Canada CETA</b>	<b>EU-Ukraine DCFTA</b>
<b>Market Access</b>	<b>Trade in Goods and Customs Duties<sup>(*)</sup></b>	<b>National Treatment &amp; Market Access for Goods<sup>(*)</sup></b>	<b>National Treatment &amp; Market Access for Goods<sup>(*)</sup></b>	<b>National Treatment &amp; Market Access for Goods</b>	<b>National Treatment &amp; Market Access for Goods<sup>(*)</sup></b>
	-	<i>Textiles and Apparel</i>	-	-	-
	-	-	-	<i>Agriculture</i>	-
	<b>Services</b>	<b>Cross Border Trade in Services</b>	<b>Trade in Services, Establishment and Electronic Commerce</b>	<b>Cross Border Trade in Services</b>	<b>Establishment, Trade in Services and Electronic Commerce</b>
	-	<i>Financial Services</i>	<i>Financial Services</i>	<i>Financial Services</i>	<i>Financial Services</i>
	-	<i>Telecommunications</i>	<i>Telecommunications Services</i>	<i>Telecommunications</i>	<i>Electronic Communications</i>
	-	<i>Electronic Commerce</i>	<i>Electronic Commerce</i>	<i>Electronic Commerce</i>	<i>Electronic Commerce</i>
	-	<i>Temporary Entry for Business Persons</i>	-	<i>Temporary Entry</i>	<i>Temporary Presence of Natural Persons for Business Purposes</i>
	-	-	<i>Computer Services</i>	-	<i>Computer Services</i>
	-	-	<i>Postal and Courier Services</i>	-	<i>Postal and Courier Services</i>
	-	-	<i>International Maritime Transport Services</i>	<i>International Maritime Transport Services</i>	<i>Transport Services</i>
	-	-	<i>Exceptions</i>	-	-

<sup>19</sup> See the website <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1230>.

<sup>20</sup> See the website <https://ustr.gov/tpp/>.

	<b>TTIP</b>	<b>TPP</b>	<b>EU-Korea FTA</b>	<b>EU-Canada CETA</b>	<b>EU-Ukraine DCFTA</b>
	-	-	<i>Payment and Capital Movements</i>	-	<i>Current Payments and Movement of Capital</i>
	-	-	-	<i>Mutual recognition of professional qualifications</i>	-
	-	-	-	<i>Domestic regulation concerning services</i>	-
	<b>Public Procurement</b>	<b>Government Procurement</b>	<b>Government Procurement</b>	<b>Government Procurement</b>	<b>Public Procurement</b>
	<b>Rules of Origin</b>	<b>Rules of Origin and Origin Procedures</b>	<b>Rules of Origin</b>	<b>Rules of Origin and Origin Procedures</b>	<b>Rules of Origin</b>
<b>Regulatory</b>	<b>Regulatory Coherence</b>	<b>Regulatory Coherence</b>	-	<b>Regulatory co-operation</b>	<b>Regulatory Framework</b>
	<b>Technical Barriers to Trade</b>	<b>Technical Barriers to Trade</b>	<b>Technical Barriers to Trade</b>	<b>Technical Barriers to Trade</b>	<b>Technical Barriers to Trade</b>
	-	-	-	<i>Mutual recognition on conformity assessment</i>	-
	-	-	-	<i>Good manufacturing practices for pharmaceutical products</i>	-
	<b>Food Safety and Animal and Plant Health</b>	<b>Sanitary and Phytosanitary Measures</b>	<b>Sanitary and Phytosanitary Measures</b>	<b>Sanitary and Phytosanitary Measures</b>	<b>Sanitary and Phytosanitary Measures</b>
	<b>TBTs and SPS in Specific Industries</b>	-	<b>TBTs and SPS in Specific Industries</b>	<b>TBTs and SPS in Specific Industries</b>	-
	<i>Chemicals</i>	-	<i>Chemicals</i>	-	-
	<i>Cosmetics</i>	-	-	-	-
	<i>Engineering</i>	-	-	-	-
	<i>Medical Devices</i>	-	<i>Medical Devices</i>	-	-
	<i>Pesticides</i>	-	-	-	-
	<i>Information and Communication Technology (ICT)</i>	-	-	-	-
	<i>Pharmaceuticals</i>	-	<i>Pharmaceuticals</i>	-	-
	<i>Textiles</i>	-	-	-	-
	<i>Vehicles</i>	-	<i>Motor vehicles and parts</i>	<i>Motor Vehicles</i>	-
	-	-	<i>Electronics</i>	-	-
<b>Rules</b>	<b>Sustainable Development</b>	-	<b>Trade and Sustainable Development</b>	<b>Sustainable Development</b>	<b>Trade and Sustainable Development</b>
	<i>Labour</i>	<i>Labour</i>	<i>Labour</i>	<i>Labour</i>	-
	<i>Environment</i>	<i>Environment</i>	<i>Environment</i>	<i>Environment</i>	-
	<b>Energy and Raw Materials</b>	-	-	-	<b>Trade-Related Energy</b>



	TTIP	TPP	EU-Korea FTA	EU-Canada CETA	EU-Ukraine DCFTA
	<b>Customs and Trade Facilitation</b>	<b>Customs Administration and Trade Facilitation</b>	<b>Customs and Trade Facilitation</b>	<b>Customs and Trade Facilitation</b>	<b>Customs and Trade Facilitation</b>
	<b>Small and Medium-Sized Enterprises</b>	<b>Small and Medium-Sized Enterprises</b>	-	-	-
	<b>Investment Protection</b>	<b>Investment</b>	-	<b>Investment</b>	-
	-	-	-	<i>Subsidies</i>	-
	<b>Competition</b>	<b>Competition Policy</b>	<b>Competition</b>	<b>Competition policy</b>	<b>Competition</b>
	-	<i>State-Owned Enterprises</i>	-	<i>State owned enterprises</i>	<i>Public Enterprises and State Monopolies</i>
	-	-	-	-	<i>State Aid</i>
	<b>Intellectual Property and Geographical Indicators</b>	<b>Intellectual Property</b>	<b>Intellectual Property</b>	<b>Intellectual Property and geographical indicators</b>	<b>Intellectual Property</b>
	<b>Dispute Settlement</b>	<b>Dispute Settlement</b>	<b>Dispute Settlement</b>	<b>Dispute Settlement</b>	<b>Dispute Settlement</b>
	<i>Investment Court System</i>	<i>Investor-to-State Dispute Settlement</i>	-	<i>Investment Court System</i>	-
	<i>Government-Government Dispute Settlement</i>	<i>Government-Government Dispute Settlement</i>	<i>Government-Government Dispute Settlement</i>	<i>Government-Government Dispute Settlement</i>	-
	-	<b>Trade Remedies</b>	<b>Trade Remedies</b>	<b>Trade remedies</b>	<b>Trade Remedies</b>
Other Issues	-	<b>Cooperation and Capacity Building</b>	-	<b>Domestic regulation</b>	-
	-	<b>Competitiveness and Business Facilitation</b>	-	-	-
	-	<b>Development</b>	-	-	-
	-	<b>Transparency and Anti-Corruption</b>	<b>Transparency</b>	<b>Transparency</b>	<b>Transparency</b>
	-	<b>Administrative and Institutional Provisions</b>	-	<b>Administrative and Institutional Provisions</b>	-
	-	<b>Exceptions</b>	-	<b>Exceptions</b>	-
	-	<b>Final Provisions</b>	<b>Institutional, General and Final Provisions</b>	<b>Final provisions</b>	<b>Common Provisions</b>
	-	-	-	-	<b>General Provisions</b>
	-	-	-	<b>Dialogues and bilateral cooperation</b>	-

(\*) Note that TTIP under 'Trade in Goods and Customs Duties'; TPP, EU-Korea FTA, and EU-Ukraine DCFTA under 'National Treatment and Market Access for Goods' cover both agricultural and industrial goods. On the other hand, TPP has a separate chapter on 'Textiles and Apparel'. While the EU-Canada CETA under 'National Treatment and Market Access for Goods' covers industrial goods only, there is a separate chapter on Agriculture.

The TTIP agenda can be summarised under three headings: market access, regulatory cooperation, and rules. While market access comprises the traditional tariffs and customs matters, services, origin rules, and



government procurement, regulatory co-operation focuses on elimination of TBTs and issues related with food safety, animal and plant health. Finally, rules concentrates on sustainable development, trade facilitation, investment protection, competition policy, intellectual property rights (IPR) and geographic indicators (GI), investor-to-state dispute settlement (ISDS) and government-to government dispute settlement. Since, differences in regulation between the parties may render bilateral trade to be more costly than it needs to be, the emphasis in TTIP is on regulation.

Recent developments to investment arbitration have emerged in the TTIP negotiations and the amended CETA text. ISDS has been extensively criticised on the grounds that it affects the right of Member States to regulate in order to achieve legitimate policy objectives such as the protection of consumers, and that investment dispute system through international arbitration lacks transparency. Arbitrators may lack independence and impartiality; they may be chosen from an elite group of arbitrators; ISDS may also lead to inconsistency and unpredictability of decisions. More recently, the EU has tried to satisfy such criticism within the context of TTIP negotiations formally presented its new approach on investment protection and investment dispute resolution to the US on November 12, 2015.<sup>21</sup> The objective of the new approach is to safeguard the EU and its Member States' right to regulate, while continuing to provide effective protection to foreign companies against unfair treatment, discrimination or other obligations through the Investment Court System. The EU is supporting the establishment of an Investment Court System to effectively safeguard the EU and its Member States' right to regulate, while continuing to provide effective protection to European companies against unfair treatment, discrimination or other basic obligations. This will be ensured through a new fully transparent system for resolving investment disputes, with publicly appointed judges, the highest ethical standards and the possibility to have errors corrected through an appeal instance.

TPP covers more or less similar issues as the TTIP. The main differences between TTIP and TPP is stemming from the characteristics of the negotiators involved. While TTIP is negotiated between rather homogeneous trading blocs EU and US, TPP is negotiated among countries with different incomes per capita and levels of development of public governance. Hence emphasis in the two agreements is quite different. The main differences between TTIP and TPP can be summarised as follows: First, while TTIP draft texts encompass articles on the elimination of TBTs and on sanitary and phytosanitary (SPS) measures in specific sectors of importance to the EU and US such as cosmetics, engineering, medical devices, pesticides, information and communications technology, textiles, vehicles, pharmaceuticals and chemicals, the TPP covers the elimination of TBT and SPS measures in general terms and include to a large extent material that has been agreed upon in WTO. Second, TPP has adopted the negative list approach to liberalisation of services liberalising every service sector unless otherwise specified. Sector specific issues are discussed in financial services and telecommunications. Furthermore TPP has specific chapters on electronic commerce and temporary entry of business persons.

Third, TPP when considering the removal of direct trade barriers and lowering tariffs concentrate in addition in contrast to TTIP on problems specific to textile and apparel sector. Fourth, while TTIP has a separate chapter on energy and raw materials, the same is not true in the case of TPP. Fifth, while TPP includes specific provisions on state-owned enterprises, the same is not the case in TTIP as the role of state enterprises in the EU and US are less important. Sixth, while TPP has a separate chapter on trade remedies including anti-dumping measures, countervailing measures and safeguards, the TTIP does not. Seventh, TPP has separate chapters on co-operation and capacity building for the lesser developed TPP countries, on transparency and anti-corruption, competitiveness, and administrative and institutional provisions. These issues are not covered in TTIP as they are considered of less important for the EU and

<sup>21</sup> See website [http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc\\_153955.pdf](http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf).

US. Finally, on November 12, 2015 the European Commission finalised its approach on investment protection and investment dispute resolution for TTIP. The proposal submitted to the US aims to safeguard the EU and its Members' right to regulate, while providing effective protection to EU companies through a transparent system for resolving investment disputes with publicly appointed judges, highest ethical standards and possibility to have errors corrected through an appeal instance. On the other hand, TPP considers the role of investor protection through investor-to-state dispute settlement (ISDS) approach via international arbitration.

In the case of KOREU, although less ambitious than TTIP, it is still a very advanced FTA covering most of the chapters of TTIP. It has sectoral annexes on electronics, motor vehicles and parts, pharmaceutical products and medical devices, and chemicals dealing with non-tariff barriers in those sectors. Similarly, when considering the liberalisation of services KOREU uses the positive list approach<sup>22</sup> for opening Korean services and has sector specific sub-sections on computer services, postal and courier services, and international maritime transport services. Furthermore, KOREU in contrast to TTIP does not have an investment chapter nor investor-state dispute settlement provisions. On the other hand, EU-Canada CETA is a deep and comprehensive FTA covering almost all of the chapters of TTIP. It has a sectoral annex on motor vehicles dealing with non-tariff barriers. EU-Canada- CETA uses the negative list approach to opening of services with reservations listed in two annexes. In addition, EU-Canada- CETA has sector specific subsections on computer services, postal and courier services, and international maritime transport services. Furthermore, EU-Canada- CETA has a very extensive chapter on promoting and protecting investment incorporating the new structure of an investment court system as a complement to private-to-state dispute settlement and government-to-government dispute settlement. Finally, note that the EU-Ukraine DCFTA is also a deep and comprehensive agreement covering most of the issues covered by TTIP and TPP.

There have been several attempts to quantify the effects of TTIP and TPP. Two of the latest studies on the impact of TTIP are Egger et al. (2015) and Felbermayr et al. (2015). Their results differ considerably. While according to Egger et al. (2015) estimated gains in real income range between 1 % and 2.25 % for the US and the EU respectively, the estimated gains according to Felbermayr et al. (2015) amount to 3.9 % of the EU GDP for the EU and 4.9 % of the US GDP for the US. On the other hand, the effects of TPP have been analysed among others by Petri et al. (2011) and Kawasaki (2015). While according to Petri (2011) estimated gains in real income for the US amount to 0.19 % of US GDP, Kawasaki (2015) shows that US benefit would amount to 0.8 % of US GDP.

## 3.2 Updating the EU-Turkey trade and investment relations

Table 4 highlights a key narrative of this paper, which is that the EU-Turkey CU does not cover most of the chapters included in TTIP such as agriculture, services, government procurement, SPS measures, regulatory coherence, sustainable development, small and medium sized enterprises, investment protection, and dispute settlement. Similar considerations apply in the cases of TPP, KOREU, and CETA.

<sup>22</sup> A positive list approach is one where parties to an agreement specify which sectors are covered. A negative list approach, by contrast, requires that parties specify the sectors that are not covered by commitments. The GATS uses a positive list approach to identify sectoral coverage and then a negative list approach to indicate limitations to market access and national treatment commitments in respect of sectors listed in schedules.

**Table 4 Comparison of TTIP, EU-Turkey CU, and World Bank Study on Modernisation of CU**

	<b>TTIP</b>	<b>EU-Turkey Customs Union</b>	<b>World Bank study on Modernisation of the EU-Turkey Customs Union</b>
<b>Market Access</b>	<b>Trade in Goods and Customs Duties<sup>(*)</sup></b>	<b>Free Movement of Industrial Commodities</b>	-
	-	-	<i>Agriculture</i>
	<b>Services</b>	-	<b>Services Trade</b>
	<b>Public Procurement</b>	-	<b>Public Procurement</b>
	<b>Rules of Origin</b>	<b>Rules of Origin</b>	-
<b>Regulatory</b>	<b>Regulatory Coherence</b>	-	-
	<b>Technical Barriers to Trade</b>	<b>Elimination of Technical Barriers to Trade</b>	-
	<b>Food Safety and Animal and Plant Health</b>	-	-
	<b>TBTs and SPS in Specific Industries</b>	-	-
	<i>Chemicals</i>	-	-
	<i>Cosmetics</i>	-	-
	<i>Engineering</i>	-	-
	<i>Medical Devices</i>	-	-
	<i>Pesticides</i>	-	-
	<i>Information and Communication (ICT)</i>	-	-
	<i>Pharmaceuticals</i>	-	-
	<i>Textiles</i>	-	-
	<i>Vehicles</i>	-	-
	-	-	-
	<b>Sustainable Development</b>	-	-
<b>Rules</b>	<i>Labour</i>	-	-
	<i>Environment</i>	-	-
	<b>Energy and Raw Materials</b>	-	-
	<b>Customs and Trade Facilitation</b>	<b>Customs Provisions</b>	-
	<b>Small and Medium-Sized Enterprises</b>	-	-
	<b>Investment Protection</b>	-	-
	<b>Competition</b>	<b>Competition Rules</b>	-
	<b>Intellectual Property and Geographical Indicators</b>	<b>Protection of Intellectual, Industrial and Commercial Property</b>	-
	<b>Dispute Settlement</b>	-	-
	<i>Investor-to-State Dispute Settlement</i>	-	-
	<i>Government-Government Dispute Settlement</i>	-	-
	-	<i>Trade Defence Instruments</i>	-

(\*) Note that TTIP under 'Trade in Goods and Customs Duties' covers both agricultural and industrial goods.

Turkey, a net debtor to the rest of the world, has been facing problems with the sustainability of its current account. During 2014 the current account deficit had decreased from 9.7 % in 2011 and 7.9 % in 2013 to 5.8 % of its GDP, and its external debt-to-GDP ratio according to International Investment Position data has amounted to 55.2 %. To achieve sustainability of current account, Turkey has to increase its exports considerably over time, and also increase the FDI inflows into Turkey, which are much more stable than portfolio investment inflows. Once TTIP is implemented Turkey will seek to adjust to TTIP rules on trade and investment as otherwise it will have difficulty in increasing its exports to the lucrative US and EU markets and attracting the FDI inflows. According to Egger et al. (2015) and Felbermayr et al. (2015) Turkey, if it would not adopt and implement the TTIP rules, could suffer welfare losses amounting to 0.75 % and 1.56 % of Turkish GDP, respectively. The above considerations reveal that the trade and investment relations between the EU and Turkey are in need of a major up-dating.

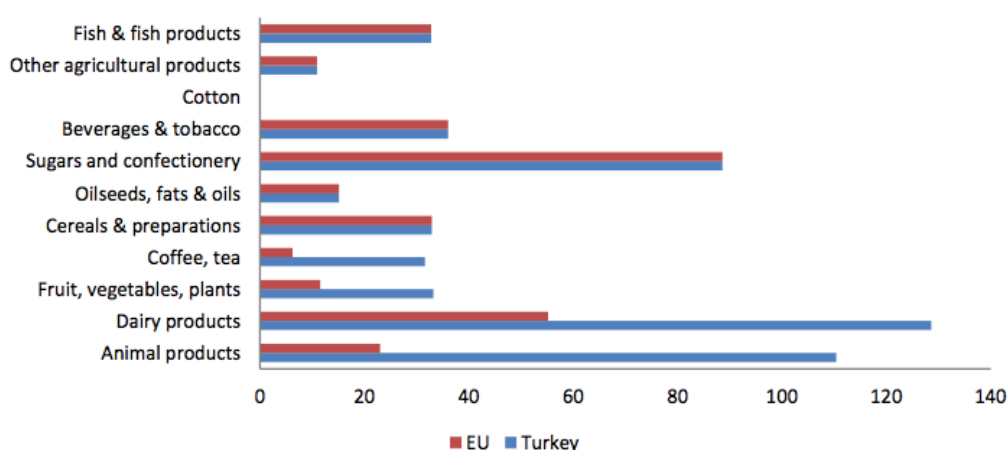
Recently the World Bank, commissioned by the European Commission, prepared the report 'Evaluation of the EU-Turkey CU'. In that report, the World Bank concluded that opportunities for widening Turkey's trade relationship with the EU should concentrate on the liberalisation of agriculture, services trade, and public procurement. In addition it is emphasised that a solution should be found to current visa restrictions. The next section briefly considers what the liberalisation of agriculture, services and government procurement would entail for Turkey.

### 3.2.1 Agriculture

In agriculture, the real challenge for Turkey is to achieve free movement of agricultural products between the EU and Turkey. Full compliance with the *acquis* will require that Turkey adjusts its policy on the one hand in such a way as to adopt the Common Agricultural Policy (CAP) measures, and on the other hand adopts and implements EU rules on SPS issues. In the EU, the *acquis* on agriculture covers a large number of binding rules. The latest CAP reforms, approved by the European Council in December 2013, set out the new rules for the CAP in the next seven-year period until 2020. They are designed to equip the European agricultural sector for the opportunities and challenges of the future. The main objectives of the reforms are to make the CAP greener and more targeted. They seek to effect a more equitable distribution of income support to farmers across the EU Member States, along with a more effective rural development policy.

The available data indicates that EU would benefit from an agreement on agriculture, either through an FTA or by extending the CU (see section 3.5) Turkey's applied MFN tariffs on imports of agricultural goods are typically high so liberalising bilateral trade and adoption of the EU's common external tariff for agriculture would imply a significant fall in import protection for certain products. According to the WTO statistics, Turkey's agricultural import tariffs averaged 41.7 percent in 2011 compared to an average of 13.9 percent for the EU. Turkey has one of the highest rates of agricultural import protection among OECD countries. All of Turkey's agricultural tariffs are bound, albeit at high rates. Turkey also maintains a statutory tariff, which can be used to increase applied tariff rates by 150 percent when deemed necessary although overall rates cannot exceed those bound under the WTO. Turkey is entitled to use export subsidies to support trade in a number of its agricultural products, including exports of these to the EU, with WTO commitments allowing export subsidies on 44 product groups. There have been EU complaints over subsidised Turkish exports of flour.

As Figure 3 highlights, tariffs are especially high for imports of processed meat and live animals, some dairy products (e.g. buttermilk and cream) and tea. Tariffs on products such as wheat, rice and red meat are also adjusted temporarily to ensure domestic production is consumed first (World Bank 2014).

**Figure 3**

*Source:* WTO World Tariff Profiles.

### 3.2.2 Services

Services cover a broad range of markets, encompassing network industries such as electricity, natural gas, and communications; other intermediate services such as transport, financial intermediation, distribution, construction, and business services; and services destined for final consumption such as tourism and travel, recreation, education, health, and environmental services. Barriers to trade in services, which are typically regulatory in nature, lead to inefficiencies in service sectors and to high costs of services. Since the productivity and competitiveness of goods and services firms depend largely on access to low cost and high-quality producer services such as transportation, distribution, telecommunications and finance, and since they have powerful influence on economic growth, it is of utmost importance to increase the efficiency of service industries which in turn can be achieved through liberalisation of trade in different service sectors. As in the case of agriculture the challenge for Turkey is to achieve free trade of services between the EU and Turkey. But this will require that Turkey adopts and implements for each of the service sectors it intends to liberalise the regulatory framework of the EU.

In the EU services can be classified under three headings: (i) services where EU wide regulations apply such as financial services, telecommunication services, energy services, and transportation services; (ii) services regulated by Services Directive 200/123/EC such as legal services, accounting services, business related services, and construction services; and (iii) services regulated by national regulations such as public services including health services, education services, and social services. A future deep integration trade agreement covering liberalisation of services between the EU and Turkey will most probably include services in the first group and some of the services in the second group, but will exclude services regulated nationally. Both the EU and Turkey are among the 23 negotiating parties to the Trade in Services Agreement (TiSA), that together account for 70 % of world trade in services.

From the EU perspective, services are a significant element of both the global and internal EU economy. The EU is the world's largest exporter of services, which translates into employment for millions throughout Europe in the services sector. Clearly then, for the EU, opening up markets for services will mean more growth and more jobs. The EU's initial offer and negotiating proposals are all publically available and could form the basis for a EU-Turkey services chapter in an FTA that extends beyond the GATS, to fully incorporate financial services and Mode 4 issues. For example, the EU's TiSA proposal includes a suggestion to incorporate procedural commitments on the Mode 4 temporary entry and stay of highly skilled professionals on the basis of a separate protocol. This indicates a shift in EU strategy, for traditionally the EU has not taken procedural commitments related to mode 4 in trade agreements.

However, given the more recent offensive interests of the EU in mode 4 and the importance of procedural commitments for that purpose, the EU has sought to give further impetus to the negotiations by proposing this complementary protocol as an integral element of the TiSA Agreement.<sup>23</sup>

### 3.2.3 Investment

In the area of investment, the EU strategy is to ensure a level playing field of high quality to all investors. Article 63 TFEU prohibits all restrictions on the movement of capital and payments between the EU Member States. The functioning of the internal market is based on the fundamental notion of non-discrimination and the understanding that restrictions and exceptions to the free movement of capital should be limited as much as possible. However, in the EU, rather than negotiating EU level investment agreements, FDI agreements until recently were concluded bilaterally by individual Member States through Bilateral Investment Treaties (BITs), the aim of which has been and still is to promote investments by guaranteeing, inter alia, non-discriminatory treatment of investors from either party by guaranteeing most-favoured nation (MFN) treatment, fair and equitable treatment, free transfer of capital without restrictions, and compensation in case of unjustified expropriation. After entering into force of the Lisbon Treaty in 2009 the EU according to Article 207 of the Treaty on the Functioning of European Union (TFEU) has exclusive common commercial policy competence on FDI. Thus, FDI is now part of EU's common commercial policy, and EU Commission may legislate on FDI although the individual BITs of Member States will be preserved until they will be replaced by EU wide investment deals.

The EU's investment strategy is based on the belief that investment is essential. On the one hand, outward investment helps European companies improve their competitiveness; while on the other hand inward investment is responsible for employing 7.3 million people in the EU. Investment in both directions is a key part of the infrastructure that connects the European economy to global value chains. The EU's 'Investment plan for Europe' seeks to boost investment, which in 2014 was 15 % down on pre-crisis levels. A key tool to promote investment is through international agreements. This will also assist the EU's strategy to liberalise trade in services. This is because facilitating trade in services also requires openness to foreign direct investment. Over 60 % of EU direct investment abroad is connected to trade in services. International trade in services requires companies to establish in markets abroad to deliver services to new local customers. WTO estimates indicate that two thirds of services are delivered through establishment. Investing around the world also allows service companies to offer global solutions to customers at home, supporting the connections of EU manufacturing and service companies to global value chains (EU Trade for All Strategy 2015). The EU investment strategy also includes sustainable development objectives. It seeks to engage with partners to promote human rights, labour rights and environmental, health and consumer protection, support development and control corruption. The objective is for key policies for the future of Europe's integration into the world economy, like investment and regulatory cooperation, to support these broader sustainable development objectives and ensure that any changes to levels of social, labour or environmental protection are upward.

An EU-Turkey deep integration RTA with an investment chapter could therefore serve the EU's overall investment strategy and as well as Turkey. Both parties are interested in securing for their investors protection against discrimination in terms of most-favoured-nation treatment and national treatment. Both parties desire protection against expropriation of their investors' assets, if these expropriations are not for public policy purpose and not fairly compensated, as well as fair and equitable treatment and the right to transfer capital – for these are also basic requirements of the more recent investment treaties. In addition, performance requirements and other sustainable development and public policy safeguard provisions could be included to ensure that the liberalisation of investment between the EU and Turkey

<sup>23</sup> <http://trade.ec.europa.eu/doclib/press/index.cfm?id=1133>



does not lead to a relaxing of labour or environmental standards to attract more investment, or that fundamental domestic policy objectives are undermined.

Attractive models already exist in the EU-Canada CETA discussed above, or the TPP Agreement Investment Chapter. This includes a set of core obligations such as (i) providing for national treatment and most favoured nation treatment, (ii) providing minimum standard of treatment for investments including protections against denial of justice and failure to provide police protection, (iii) ensuring that if a TPP government expropriates an investment, it does so for a public purpose, in accordance with due process of law, and subject to prompt, adequate and fully realisable and transferable compensation, (iv) allowing for transfer of funds related to an investment covered under the Agreement, (v) barring specified performance requirements, including local content requirements, export requirements, and technology transfer or technology localisation requirements, and (vi) ensuring investors have the ability to appoint senior managers without regard to nationality, and ensuring that any nationality-based restrictions on the appointment of board members do not impair an investor's control over its investment. The TPP countries have agreed to accept these obligations on a negative-list basis.

### 3.2.4 Public procurement

Tendering for public contracts is about how public authorities spend taxpayers' money when buying goods, services or works. Currently, Turkish companies face obstacles in winning public contracts in the EU and EU companies face obstacles in winning public contracts in Turkey due to the widespread use of domestic content requirements, particularly in high tech procurements. Moreover, while the Turkish the Public Procurement Law (4734) sets out principles and requirements to ensure a transparent and fair tendering process, as well as provisions to control corruption and probity, enforcement records are poor. Procurement practices have been criticised for becoming less transparent, with amendments to procurement law placing tenders in sectors such as defence, security, intelligence, technology, and railways outside of the purview of the monitoring watchdog Public Procurement Authority (KİK). Moreover, judicial reforms in 2012 reduced criminal charges for bid-rigging in public tenders (Freedom House 2014:12). Further market opening based on the principles of transparency, non-discrimination and procedural fairness would be good for both the EU and Turkey. For public authorities with tight budgets it can bring (i) better money for value, (ii) more choice, (iii) greater economic efficiency and (iv) good governance. If parties could agree on rules which will ensure that they are not discriminated against in public procurements, agree on rules to maximise transparency in tendering for public contracts, and maximise the opportunities for firms of both parties to participate in tenders at all government levels, both parties would win.

The EU's established RTA procurement chapters are fully in line with the WTO Government Procurement Agreement (WTO GPA) as regards the rules governing procurement procedures, transparency, eligibility, administration and domestic remedies. The plurilateral WTO GPA provides a limited number of 45 parties with a framework for ensuring that the procurement covered under the Appendix to the chapter is conducted in a competitive non-discriminatory and transparent manner. It includes tender procedures, performance requirements, the prohibition of offsets, transitional measures, public policy exceptions and a requirement for a bid review mechanism at the domestic level, to provide redress to disappointed bidders, and an opportunity to bring the complaint to the State level through notification to the implementation body (Dawar and Evenett, 2011). The TPP Procurement Chapter 15 is fully comprehensive and it is based on the WTO Government Procurement Agreement legal framework. The EU is an active party to the WTO GPA. It is therefore most likely that the commitments will either conform to the WTO GPA or include further concessions in certain areas of coverage, and could therefore be considered a WTO GPA+ RTA. An EU-Turkey procurement chapter could usefully include more detailed wording on electronic procurement websites which conform to intra-EU arrangements, and it could also seek to prevent corruption in procurement tenders, as with the 2014 WTO GPA. This would be of further

benefit in opening up the de facto access of smaller firms to procurement markets in both the EU and Turkey. The market access coverage of the procurement chapter could also be tailored to ensure that Turkey is able to gain transitional measures where necessary to open up procurement markets on a more incremental basis, until they reach a level comparable with the EU. For example, Turkey may be given transitional timeframe for implementing the provisions prohibiting certain local content requirements, supported by capacity building measures.

A comprehensive procurement chapter would provide Turkey a framework from which to accede to the WTO Government Procurement Agreement, which could be considered the ultimate goal for Turkey and the EU. It would also shelter Turkish firms from EU instruments such as the proposed International Procurement Instrument (IPI).<sup>24</sup> The IPI as currently proposed, lays down procedures for contracting authorities to reject tenders or contracts of an estimated value of EUR5 million or above and consisting of more than 50 % of goods or services, which are not subject to the EU's international procurement commitments in the WTO GPA or its RTAs. This instrument provides the EU with a unilateral tool to increase leverage when negotiating access to public procurement markets of other trading partners, not currently party to the WTO GPA or its RTAs, such as Turkey. However, from the EU perspective, liberalisation of procurement markets is more transparent and better achieved through negotiating a comprehensive chapter with deep concessions.

In sum: it will be quite a challenge for Turkey to achieve free movement of agricultural commodities between the EU and Turkey since the rules of EU *acquis* on agriculture and food safety, veterinary and phytosanitary policy are quite different from those prevailing in Turkey. It will be a further challenge for the country to achieve the liberalisation of services since the rules of the EU *acquis* on services and public procurement are again quite different from those prevailing in Turkey. Given the protection that domestic firms receive on domestic procurement markets, it would also be a challenge for Turkey to accede to the WTO Government Procurement Agreement for example. But, the liberalisation of agriculture, services, investment and public procurement, while costly, is a must for Turkey if it wants to stay competitive in the world economy, and increase its exports and FDI inflows. Similar considerations apply to investment and dispute settlement issues. For the EU, the benefits of extending the level playing field for EU trade and investment are conclusive. The EU Trade for All Strategy is based on the understanding that trade has never been more important for the EU economy and this became clear with the onset of the 2008 financial crisis. International trade and investment is crucial when EU domestic demand is weak. The projections suggest that by 2030 around 90 % of global economic growth will be generated outside Europe. Currently, more than 30 million jobs are supported by exports outside the EU, which is two thirds more than 15 years ago and as a result, exports now support almost one in seven jobs in Europe.

### 3.3 Choices facing Turkey

The above considerations reveal that the present EU-Turkey CU could be modified to take into account the various criticisms of the CU summarised in section 1.3, and liberalisation of agriculture could be achieved by extending the present CU to agriculture. On the other hand, liberalisation of services and public procurement could be achieved by signing a separate FTA with the EU covering those sectors. Alternatively, the present EU-Turkey CU could be modified to take into account the various criticisms of the CU summarised in section 1.3, and a separate FTA with the EU could be signed covering agriculture,

<sup>24</sup> Amended proposal for a Regulation of the European Parliament and of the Council on the access of third-country goods and services to the Union's internal market in public procurement and procedures supporting negotiations on access of Union goods and services to the public procurement markets of third countries. Brussels, 29.1.2016 COM(2016) 34 final. (henceforth: the IPI Proposal).



services and public procurement. In addition to the areas covered by the World Bank (2014), it is our strong belief that a deep integration agreement between the EU and Turkey should also cover issues related with investment and dispute settlement.

According to United Nations Conference on Trade and Development (2015) the average FDI inflow into Turkey during the last three years amounted to USD12.6 billion, average outflow USD4.8 billion, the FDI inward stock during 2014 USD168.6 billion, and FDI outward stock USD40.1 billion. On the other hand, the average FDI inflow into the EU during the last three years amounted to USD318.5 billion, average outflow USD294 billion, the FDI inward stock during 2014 USD9.2 trillion, and FDI outward stock USD10.4 trillion. Since FDI is increasing competition and boosting trade, it will optimise resource allocation in the economy, create jobs, and transfer technology and skills. Hence, FDI is very important for both the EU and Turkey. Following the TTIP negotiations, the final text on investment will be incorporated into the TTIP and Turkey will be forced to adjust its investment system to the new rules. Therefore, it would be expedient for both parties to use the TTIP investment chapter as the basis for negotiating concessions.

At the Workshop on 'Bringing EU-Turkey Trade and Investment Relations up to Date' held at European Parliament in Brussels on March 17, 2016 Mr. Murat Yapıcı, Director General for EU Affairs at the Ministry of Economy of Turkey emphasised that Turkey is considering the various options for the liberalisation of services but would be reluctant to liberalise agriculture and public procurement. On the other hand, during the Workshop Mr. Ignacio Garcia Bercero (Director of the European Commission's Directorate General for Trade), pointed out that the EU Commission is interested in the liberalisation of not only services, but also in the liberalisation of agriculture and public procurement.

### 3.4 Choices facing the EU

Strengthening the global role of the EU is among the ten priorities of the European Commission for the 2014-19 period. In addition to upgrading trade relations with countries such as Mexico and Chile, these priorities state that the EU's trade relations with Turkey require an overhaul. Alongside modernising trade and investment relations, the increase in the strategic importance of EU-Turkey relations is significant, due to changes in international and regional relations related to the Middle East and the refugee crisis. The EU needs to act jointly with Turkey. This cooperation requires a foreign policy vision that embraces enlargement negotiations and a progressive neighbourhood policy. Turkey and the EU share mutual benefits in foreign policy security, border management, and migration policies.

Turkey is important to the EU's political as well as economic wellbeing. The EU is striving to maintain its competitiveness and recover fully from the impact of the 2008 fiscal crisis. It is therefore significant that the available evidence from the EU Member States indicates that a 1 % increase in the openness of the economy results in a 0.6 % rise in labour productivity the following year. The EU Union has more to lose than gain from protectionist measures, since it is dependent on many imported products. Raising their cost would reduce the EU's competitiveness inside and outside the Union leading directly to a loss of European production and jobs. A 10 % rise in trade restrictions could lead to a 4 % loss in national income. (European Commission, 2014)

The existing quantitative research suggests<sup>25</sup> that European companies support the widening the scope of the existing customs union and that any new agreement should include capacity building on how to exploit trade and investment opportunities for European companies in Turkey. Further, for European businesses, improving the sustainable development dimension of the business environment in Turkey in terms of raising labour and environmental standards, is as important as actively promoting the Turkish

<sup>25</sup> EU-Turkey Relations: Perspectives from the European Business Community Eurochambres and TOBB – 2013. See website [http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc\\_153955.pdf](http://trade.ec.europa.eu/doclib/docs/2015/november/tradoc_153955.pdf).

market in Europe. (Eurochambers 2013). European companies state that the CU should be improved and extended to new areas, such as services, investment, agricultural products as well as consumer protection and food safety. This would improve the regulatory environment in Turkey, and generate new business opportunities. The majority of European companies (82 %) operating or investing in Turkey consider that important barriers to trade and investment remain. These surveys suggest that existing progressive alignment of Turkish legislation to the EU *acquis* is considered to have already positively changed the business environment since 1995 but that more needs to be done. In sum, while Turkey is already well advanced in implementing several essential legislative and administrative reforms in relevant areas, the legal and institutional situation in Turkey, and its level of overall cooperation with the EU remain lower than necessary.

The EU would gain significantly in the areas of investment, procurement, services and agriculture as well as the further internationalisation of its regulatory frameworks and norms, from deeper integration with Turkey. It would extend EU principles of sustainable development through provisions covering trade and labour, trade and environment, as well as transparency, good governance and corruption control.

## 3.5 Identifying options

Having examined the general and specific issues involved in updating EU-Turkey trade and investment relations to meet the needs and expectations of both parties in the 21<sup>st</sup> century, this section identifies the available policy options. Of the five options discussed below, the first two are considered to be non-options - doing nothing, and full accession. Nevertheless, they are briefly included in order to put forward the full spectrum of possible choices for analysis.

### 3.5.1 Baseline scenario: Do nothing

While this option has the advantage of requiring no further resources, legal instrument or legislative mobilisation, for all the reasons discussed in this report, this option is not considered further. Without adapting or modernising EU-Turkey commercial relations, the opportunities identified above, relating to exploiting the governance and economic benefits of liberalising procurement, services and agricultural markets will be lost. Moreover, the weaknesses and challenges arising from the status quo will persist, such as the lack of sustainable development provisions in EU-Turkey trade relations, lack of value for money and transparency in procurement markets, from the legal perspective the problems involved in requiring a 'Turkey Clause' in EU RTAs, and the lack of rules based framework for settling disputes under the existing Customs Union. Taken together these flaws risk creating greater issues of economic irrelevance, political illegitimacy and ultimately inapplicability, while forgoing the potential economic and diplomatic benefits of deeper integration between the EU and Turkey.

### 3.5.2 Turkey gains full EU Membership

The legal avenue for enlarging the EU to incorporate Turkey entails Turkey complying fully with the *acquis*. This would entail a continuation of Turkey accession process. Indeed, unless new initiatives are established, this option could de facto result in the base scenario option of doing nothing.

Turkey applied for full membership in 1987, was confirmed as candidate in December 1999 and negotiations started in October 2005 when Turkey had met the conditions for accession talks extending the CU with the EU to all new Member States, including Cyprus. However, after failing to open up its ports and airports to Cypriot traffic, the EU responded by freezing accession talks in eight policy areas in 2008. Subsequently Cyprus and France blocked further chapters.

The new "positive agenda" initiated in May 2012 began with the EU and Turkey identifying areas for expanding co-operation, but then stalled when Cyprus took up the EU's six-month rotating presidency in July 2012 and communications between Turkey and the Cyprus authorities broke down. As a result of these protracted delays, only 13 of Turkey's 35 negotiating chapters were opened, and only one closed.

The opening of Chapter 17 on Economic and Monetary Policy in the EU's membership talks in 2015 marked the first formal discussions since 2013 and what many see as a fresh start for EU-Turkey ties after years of uneasy relations. Underlying that change is Turkey's promise to help stem the flow of migrants to Europe in return for cash, visas and renewed talks on joining the EU, to which Ankara formally started its membership talks a year ago.

While full accession would remove the external legal constraints on Turkey participating in EU external trade relations and allow the full potential of integration to be realised. It is both technically and politically unlikely in the short term, and moreover, Turkey would still need to be in compliance with the *acquis* before this could happen.

### 3.5.3 Modernise the current CU

This option would require amendment of Decision 1/95. It would allow for enhancing bilateral trade relations while providing for improved implementation and dispute settlement mechanism. It could potentially also address agriculture. An enhanced CU expected to increase FDI-flows from the EU, in addition to expanding trade into a diversified range of sectors, is likely to offer an effective remedy to the "middle income trap."

The negative aspect of this side is that Turkey remains locked out of EU-third party negotiations, with repercussions of tariff preference erosion, and democratic deficit in decision making for Turkey. Moreover, it would omit various other deep integration issues such as services, investment and procurement are required to modernise EU-Turkey economic relations.

### 3.5.4 Complement the current CU with a new comprehensive FTA

An extended CU could incorporate agriculture, while being accompanied by negotiating a complementary deep integration RTA covering services, government procurement, investment, dispute settlement. The RTA could also extend the rules on TBTs, IPR and competition present in the EU-Turkey CU, if they were not handled under the modernisation of the CU.

The negative aspect of this side is again that Turkey remains locked out of EU-third party negotiations, with repercussions of tariff preference erosion, and democratic deficit in decision making for Turkey. Moreover, it does not result in a unified comprehensive set of rules covering trade in goods, services and investment, and the inter-linkages between these markets.

### 3.5.5 EEA Membership

A halfway house is for Turkey to join the EEA.<sup>26</sup> Advocates for this position argue that adopting the EEA agreement would not require conforming to the *acquis*, but would still allow Turkey and the EU to engage in freer trade. EEA membership would therefore facilitate commerce on the one hand, and provide Turkey with social and political benefits such as reduced visa requirements, while increasing social and environmental standards on the other hand. Article 20 EEA addressing the free movement of persons stipulates that its provisions are subject to member agreement, which would address concerns about providing Turkey with full residency rights in Europe.

The EEA option would extend the geographical scope of the Internal Market and its flanking policies to Turkey. Membership of the EEA would also provide decision-shaping, continuous take-over of new EU legislation on the internal market with the EFTA court presiding over it. This is a 'privileged partnership'

<sup>26</sup> Agreement on the European Economic Area - Final Act - Joint Declarations - Declarations by the Governments of the Member States of the Community and the EFTA States - Arrangements - Agreed Minutes - Declarations by one or several of the Contracting Parties of the Agreement on the European Economic Area, OJ L1, 3.1.1994, pp. 3-522.

and can be fully integrated with pre-accession. This would provide less pressure on political issues such as improving Turkey's relationship with Cyprus, while providing the benefits of integration in the internal market. Joining the EEA extend the customs union between the EU and Turkey by ensuring a very deep and wide internal market, with the exception of agriculture and fisheries. It would combine deeper economic integration with common institutions for surveillance and adjudication of infringements, when they arise.

The disadvantage with this option is that this option would result in a permanent waiting room for Turkey because striving for EU membership is not the premise of the EEA. Moreover, the EEA is an FTA and therefore if Turkey joined it would preclude Turkey's participation in the EU customs union or in the Common Commercial Policy. This is because it would provide deeper economic integration with the EU than enjoyed by current EEA countries. However, this option could be perceived as backtracking on accession-oriented aspects of CU, either as a EEA Membership is seen as a waiting room until full EU accession, following the examples of Austria, Finland and Sweden, or as a permanent solution, following Norway and Liechtenstein.

### 3.5.6 Replace the current CU with a new comprehensive FTA

This option involves negotiating a completely new agreement along the lines of the more recent deep integration RTAs that the EU has negotiated with Canada, Korea or in the future TTIP, discussed above. Thus, it would result in a comprehensive agreement with chapters covering industrial goods, agriculture, services, TBT, IPR, investment, competition and public procurement and enforced through dispute settlement provision.

This option would require substantial adaptations to the Association Agreement because it represents a major shift in EU-Turkey contractual relations. Approval would have to be granted either through a new Decision of the Association Council or through a new Protocol to the Association Agreement, which would require a full treaty-making procedure, pursuant to TFEU Articles 217 and 218. This choice has the advantages of incorporating the necessary new issues that would modernise the agreement and bring it in line with more contemporary developments in regional agreements. If a comprehensive RTA replaced the CU, it would remove the difficulty of Turkey's exclusion from EU Trade external relations negotiations.

However, as with the option of EEA Membership, completely replacing the CU with a deep integration RTA could be perceived as backtracking on progress made to date on the accession-oriented aspects of CU. It might also incur increased transaction costs linked to rules of origin.

## 4 Conclusions and recommendations

This paper maintains that the EU-Turkey Customs Union of 1995, limited to industrial goods, should be modernised and modified to take into account the various and growing criticisms of the CU. A consideration of the various areas of modernisation and the different options available suggests that further economic integration between the EU and Turkey should be directed towards signing a complementary deep integration RTA between the EU and Turkey covering agriculture, SPS measures, services, government procurement, investment, and dispute settlement. Such an approach should increase competition and lead to better allocation of resources in both Turkey and the EU. Despite raising doubts about full accession in the short run, there is nevertheless absolutely no evidence that either Turkey or the EU and its Member States wants to unilaterally break with Turkey's accession process. This is because of the various interdependencies, as well as the high potentials of their partnership in terms of politics and security, economy, trade and energy, as well as socio-cultural relations.

The EU continues to face various internal and external challenges. Internal fissures are appearing caused by growing inequality and the difficulties in post-crisis recovery of the Euro zone. There is an urgent need to identify new sources of growth and employment. Private investment in innovation is falling short of the target, while there is a growing brain drain mostly from regions worst affected during the crisis and the subsequent austerity measures. Externally, the Union's neighbourhood has become an area of high risk with an increasing number of open conflicts challenging Europe's security. They pose immediate threats to Europe's security and trigger asylum seeking immigration that puts pressure on EU external borders and relevant policies from migration to humanitarian assistance and development cooperation.

Deepening EU-Turkey integration would offer significant gains for the EU as well as for Turkey. Signing a deep integration RTA should increase market access through eliminating tariff and non-tariff barriers to the EU market, and will facilitate the fulfilment of the requirements of TTIP. These are considerable advantages for Turkey. Turkey understands the growing importance of global value chains trade, and how concluding deep and comprehensive FTAs such as TPP, KOREU or EU-Canada CETA would potentially allow them to grow economically. This process would also allow them to realise further achievements in the TTIP negotiations. The country is aware that the twenty-year old EU-Turkey CU no longer meets the requirements of the 21st century trade. It is consequently interested in up-dating the EU-Turkey trade and investment relations, but it is not sure how this up dating should take place.

This suggests that the most tangible option is to complement the CU with a deep integration agreement to bring EU-Turkey trade and investment relations into line with current EU RTAs, such as the KOREU, EU-Canada CETA, and the TTIP. The chapters of the TTIP will most probably contain stronger provisions than the EU-Turkey CU. Since under the TTIP negotiations it is likely that a harmonisation approach will be followed in some areas, while in other cases a mutual recognition or mutual equivalence approach. As such, meeting the requirements of the EU will make it easier for Turkey to fulfil the requirements of TTIP. In sum, for Turkey the challenge is to achieve liberalisation between the EU and Turkey. For the EU this is an opportunity to harness the economic and political potential of deeper integration with Turkey, through the further liberalisation of trade in goods, services, agriculture, and encouraging sustainable investment.

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## Powerpoint presentations

Dr Sübidey TOGAN



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- Turkey-EU Customs Union
- Recent Developments in the World Economy
- Up-Dating the EU-Turkey Trade and Investment Relations



## Turkey-EU Customs Union

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- The EU-Turkey Customs Union (CU) of 1995 has been a major instrument of integration into the EU and global markets for Turkey, offering the country powerful tools to reform its economy. It has credibly locked Turkey into a liberal foreign trade regime for industrial goods and held the promise of Turkey's participation in the EU internal market for industrial products.



## Turkey-EU Customs Union

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- The Turkish producers of industrial goods are now protected by tariffs from external competition to exactly the same extent as EU producers are and as such, they face competition from duty-free imports of industrial goods from world-class pan-European firms. In return, Turkish industrial producers have duty-free market access to the European Economic Area.



## Turkey-EU Customs Union

- Under the CU Turkey was required adopt all the preferential agreements the EU had concluded and will conclude with third countries. In addition Turkey had to adopt and effectively apply the EU rules on modernization of customs; elimination of technical barriers to trade (TBTs); competition policy; intellectual property rights; and anti-dumping, countervailing duties, surveillance and safeguard measures.



## Turkey-EU Customs Union

- Prior to the formation of CU Turkey had a very complicated import regime. At the border shipments had to be physically inspected. In addition, Turkey did not have the infrastructure nor the technical knowledge required for the elimination of TBTs. Third, Turkey did not have specific competition legislation nor competition policy enforcement. Fourth, the intellectual property regime was not up to the world standards. Finally, anti-dumping, countervailing duties, and safeguards were new policy measures introduced only after the CU.



## Turkey-EU Customs Union

- The EU-Turkey CU has not been without its critics. They point out among others the following problems: (i) The FTAs concluded by the EU do not take into account Turkey's special interests; (ii) Turkey suffers tariff revenue losses when importing commodities from third countries via the EU; (iii) There are latecomer effects. Since Turkey can conclude FTAs only after the EU has concluded FTAs, Turkish exporters are put into disadvantageous position; (iv) Some of EU's trade partners concluding FTAs with the EU refrain from concluding FTAs with Turkey despite the 'Turkey Clause'.



## Turkey-EU Customs Union

- The World Bank in its report 'Evaluation of the EU-Turkey CU' considers in addition the following problems:
  - (a) The road transport quotas and transit permits hinder the free circulation of goods covered by the CU.
  - (b) The use of Trade Defence Instruments like anti-dumping and safeguard measures harms trade.
  - (c) The current visa regime has repercussions on EU-Turkey trade and business relationships.



## Recent Developments in the World Economy

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- During the period when Turkey was trying to implement the requirements of the EU-Turkey CU major changes were taking place in the world economy. Since the middle of 1980s the developments in telecom and internet triggered a suite of information-management innovations that made it easier and cheaper to coordinate complex production activities from a distance. Some production stages previously performed in close proximity were lately dispersed geographically. Manufacturing today is increasingly managed through global value chains (GVCs).



## Recent Developments in the World Economy

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- For developing countries to benefit from increased GVC trade it is essential that tariffs are eliminated, transport cost and administrative costs are low, and delays do not occur. Lower barriers to investment are a must for participating in GVC trade. Furthermore, a high quality transport infrastructure with major international gateways and corridor infrastructures such as airports, harbors, railways and highways facilitates economies' participation in GVCs. The sharing of tacit and explicit technology and intellectual property requires that foreign knowledge and capital owners are treated fairly and their property rights are respected.

## Recent Developments in the World Economy

Since issues raised by the GVC trade could not be negotiated in DOHA Round of multilateral trade negotiations, US, EU and Japan have decided to establish the rules of GVC trade regionally rather than multilaterally. They started to sign FTAs with deep provisions that are pro GVC trade. They also signed Bilateral Investment Treaties (BIT) tackling different investment issues. The developing countries responded by introducing unilateral reforms in order to benefit from GVC trade. As a result, the WTO centrality in global trade governance started to erode.

## Recent Developments in the World Economy

- Of the recent trade agreements already concluded/presently negotiated by the EU and US the most important ones emphasizing in particular those by EU are the Trans-Pacific Partnership (TPP), Trans-Atlantic Trade and Investment Partnership (TTIP), EU-Korea FTA (KOREU), Canada-EU Comprehensive Economic and Trade Agreement (CETA), and EU-Ukraine Deep and Comprehensive Free Trade Area (DCFTA).

## Recent Developments in the World Economy

- Comparison of these trade agreements among themselves reveals that the agreements cover more or less similar issues. Since TTIP among these agreements will most probably be the dominant agreement, once it is concluded, we note that issues covered by TTIP will determine the rules of the 21<sup>st</sup> century trade.
- TTIP can be summarized under the headings of market access, regulatory co-operation, and rules.

## Recent Developments in the World Economy

- While market access comprises the traditional tariffs and customs matters, services, rules of origin, and government procurement; regulatory co-operation focuses on elimination of TBTs and issues related with food safety, animal and plant health. Finally, rules concentrate on sustainable development, trade facilitation, investment protection, competition policy, intellectual property rights (IPR) and geographic indicators (GI), small and medium sized enterprises, investor-to-state dispute settlement, and government-to-government dispute settlement.





## Up-Dating the EU-Turkey Trade and Investment Relations

- Comparison of the EU-Turkey CU with TTIP reveals that the EU-Turkey CU does not cover most of the chapters included in TTIP such as agriculture, services, government procurement, SPS measures, regulatory coherence, sustainable development, small and medium sized enterprises, investment protection, and dispute settlement. Similar considerations apply also in the cases of TPP, KOREU, and EU-Canada CETA.



## Up-Dating the EU-Turkey Trade and Investment Relations

- Recently, the World Bank in its report 'Evaluation of the EU-Turkey CU' concluded that opportunities for widening Turkey's trade relationship with the EU should concentrate on the liberalization of agriculture, services trade, and public procurement.
- Once TTIP is implemented Turkey realizes that it will have to adjust to TTIP rules on trade and investment as otherwise it will have difficulty in increasing its exports to the EU and US markets and attracting the FDI inflows to Turkey from these countries.

## Up-Dating the EU-Turkey Trade and Investment Relations

- According to Egger et al. (2015) and Felbermayr et al. (2015), if Turkey would not adopt and not implement the TTIP rules, the country could suffer welfare losses amounting to 0.75% and 1.56% of Turkish GDP, respectively. Since the twenty years old EU-Turkey CU does no longer meet the requirements of the 21<sup>st</sup> century trade, Turkey is very much interested in up-dating the EU-Turkey trade and investment relations. But, it is not sure how this up-dating should take place. Similar considerations probably apply for the EU.

## Up-Dating the EU-Turkey Trade and Investment Relations

- The present paper maintains that the EU-Turkey CU of 1995 covering industrial goods should be modified to take into account the various criticisms of the CU. In addition, economic integration between the EU and Turkey should be strengthened by signing a FTA between the EU and Turkey covering at least agriculture, SPS measures, services, government procurement, investment, and dispute settlement.



## Up-Dating the EU-Turkey Trade and Investment Relations

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- Such an approach by increasing competition in the Turkish economy will lead not only to better allocation of resources in Turkey, but will also increase Turkish firm's access to the EU market and benefit from increased GVC trade. It may also facilitate the fulfillment of the requirements of TTIP for joining the TTIP in the long run and eventually signing a FTA with the US. These are considerable advantages for Turkey.



## Up-Dating the EU-Turkey Trade and Investment Relations

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- The harmonization of Turkish rules and regulations in agriculture, SPS measures, services, government procurement, investment and dispute settlement to EU rules and regulations will provide new business opportunities for European companies in many agricultural and service sectors and also in government procurement markets providing considerable advantages for the EU.



*Thank you*

# Updating EU-Turkey Trade and Investment Relations

Dr Kamala Dawar



## Legal Assessment

EU-Turkey CU broadly consistent with EU's approach across its preferential agreements

- **BUT applies only to industrial goods**
  - (including industrial components of processed agricultural in free circulation in EU or Turkey)
  - MFN tariffs have only fallen for industrial goods
- **The CU requires Association Council to act unanimously**
  - equal representation of each party - precludes representation by individual MS
  - both party possess the right to veto any decision
- **No provision for independent monitoring** of implementation
  - or mechanism to address weaknesses
- **Diplomatic or intergovernmental** character =>
  - Non transparent - lack of parliamentary control
  - absence of recourse to judicial dispute settlement
- **Out of Date:** with EU & int'l norms on transparency & inclusive governance



## Legal Anomalies

### Customs Union Decision 1/95 required

- Elimination customs duties, quantitative restrictions, charges and measures with an equivalent effect to customs duties
- Common External Tariffs (CET) on third-country imports of **industrial goods**
- Turkey to adopt all the preferential agreements EU concludes with third countries
  - Turkey no participation in EU external trade negotiations with third countries
- BUT third countries have no obligation or incentive to conclude agreement with Turkey
  - no incentive if already access to Turkey through EU customs union
  - e.g. US under TTIP

### Accession Process requires

- **Established alignment by Turkey with EU *acquis***
- **Regulatory regimes extending far beyond other EU trade partners obligations**
- **But third parties not in accession to EU secured broader commitments from EU than Turkey**



## EU Trade Strategy

- Updating trade policy to take account of the new economic realities such as
  - global value chains
  - digital economy
  - importance of services.
- Supporting mobility of experts, senior managers, and service providers
- A more transparent trade and investment policy by:
  - Extending the TTIP transparency Initiative to all EU trade negotiations
- A trade and investment policy **based on values** by:
  - safeguarding EU regulatory protection
- Expanding measures to support **sustainable development**
  - fair and ethical trade and human rights,
  - Including ensuring effective implementation of related FTA provisions
- A **programme of negotiations** to shape globalisation by:
  - Re-energizing multilateral negotiations – NOT UNILATERALISM
  - Designing an open approach to bilateral and regional agreements
  - Modernizing existing agreements with Turkey and the Customs Union with Turkey



## EU perspective

EU-Turkey CU narrow and shallow compared to EU's other RTAs

Compare:

- **EU-Canada CETA:** Goods, Services, IPRs, TBT, SPS, Trade Facilitation, Trade in Services, Government Procurement, Competition, Investment, Labour, Environment, Sustainable Development, Dispute Settlement
- **EU- Korea:** Goods, Trade Remedies; Technical Barriers to Trade; Sanitary and Phytosanitary Measures; Customs and Trade Facilitation; Trade in Services, Establishment and Electronic Commerce; Payments and Capital Movements; Government Procurement; Intellectual Property; Competition; Transparency; Trade and Sustainable Development; Dispute Settlement
- **EU-Ukraine (DCFTA):** framework for modernizing trade relations and opening markets via the progressive removal of customs tariffs and quotas, **and** extensive harmonization of laws, norms and regulations in various trade-related sectors, creating the conditions for aligning key sectors of the Ukrainian economy to EU standards.



## Case of Investment

**Why does EU negotiate Bilateral Investment Treaties?**

- FDI: fundamental engine for competitiveness
- EU net positive income from FDI: €75bn/year
- EU is the biggest investor and recipient of FDI worldwide
- EU outward FDI stock: € 4.15tn in 2010.

**Empirical evidence:**

- *investment provisions in preferential trade agreements have positive impact on inward FDI*
- *EU outward investment has positive impact on productivity and on employment in the EU*

**Currently no EU - Turkey BIT: MS BITS with third countries**

- EU can't guarantee EU investors protection from discrimination, fair and equitable treatment, compensation, requirements for investor state arbitration
- EU cannot promote sustainable investment in Turkey: labour, human rights, environment...



## Case of Procurement

### EU- Turkey currently no procurement agreement

- European Commission's 2016 International Procurement Instrument Amended Proposal
- EU objective of encouraging greater reciprocity in procurement markets
- EU response to the lack of level playing field in world procurement markets.
- The IPI aims at encouraging partners like Turkey to engage in negotiations and opening participation for EU bidders and goods in third countries' tenders.

### 2016 IPI Proposed Regulation

In trading partners' public procurement markets **not covered by international agreements**

The 2016 IPI Amended Proposal **proposes first to seek to negotiate a procurement agreement**

- OR to impose "price adjustment measures" on non-reciprocating third party
- Will directly affect Turkish tenders
- May impose administrative burden and close market competition in EU
- IPI Not first the best solution – rather negotiating procurement agreement



## Agriculture, Services....

**Agriculture:** Decision 1/98 - EU important concessions on beef meat & live bovine

- However, Turkey ban imports of live bovine animals & beef products 1998
- RTA could remove this obstacle in EU-Turkey agricultural trade relations

**Services:** EU world's largest exporter of services:

- liberalizing services increases growth
- Both EU and Turkey negotiating TISA – speed up negotiations through FTA?
- Ex. EU- Korea FTA services chapter: scope diverse: transport, telecommunications, finance, legal services, environmental services and construction.
- Ex. EU-Korea FTA protects right to maintain public monopolies and exclusive rights for public utilities

**Trade and sustainable development:** EU commitment to labour and environmental standards Ex. CETA; EU Korea FTA set up institutional structures to implement and monitor commitments to sustainable development





## Options for Modernising EU-Turkey Trade Relations:

**1. Baseline scenario – do nothing:**

- lose identified gains from greater economic and political integration with Turkey

**2. Continue with Accession**

- not enough legislative push to give short term gains

**3. Enlarge the CU :**

Requires: amendment of Decision 1/95

Advantages: enhancing bilateral trade relations

- improved implementation and enforcement
- Address agriculture, exchange of services, establishment
- between Turkey and existing member states
- Enhanced CU expected to increase FDI-flows and diversity trade flows from the EU

**But Turkey remains locked out of EU-third party negotiations**



## Updating EU – Turkey Trade Relations

**4. Complement CU with a deep integration RTA**

– similar scope and coverage to CETA, EU- Korea , TTIP

- industrial goods, agriculture, services, investment, procurement, dispute settlement.
- **Requires:** require substantial adaptations to Association Agreement through either:
  - new Decision of Association Council
  - new Protocol to Association Agreement,
    - full treaty-making procedure (TFEU Articles 217 and 218)
- **Advantages:** incorporates necessary issues to update EU-Turkey relations
- **Advantages:** allows EU to pursue deeper integration with Turkey
  - Economically
  - Diplomatically



# Thank you

DIRECTORATE-GENERAL FOR EXTERNAL POLICIES

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PHOTO CREDIT: Stock International Inc.

ISBN 978-92-823-9227-0 (print)  
ISBN 978-92-823-9226-3 (pdf)  
doi:10.2861/320905 (print)  
doi:10.2861/36454 (pdf)

